No. 12391

United States Court of Appeals

For the Ninth Circuit.

AGNES M. KANNE, Executrix under the will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii,

Appellant,

vs.

AMERICAN FACTORS, LIMITED, an Hawaiian Corporation,

Appellee.

and vs.

AMERICAN FACTORS, LIMITED, an Hawaiian Corporation,

Appellant,

vs.

AGNES M. KANNE, Executrix under the will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii,

Appellee.

Transcript of Record

In Two Volumes

Volume I

(Pages 1 to 226)

Appeals from the United States District Court, District of Hawaii.

Phillips & Van Orden Co., 870 Brannan Street, San Francisco, Calif.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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NAMES AND ADDRESSES OF ATTORNEYS OF RECORD

For the Plaintiff, American Factors, Limited,

SMITH, WILD, BEEBE & CADES,
Bishop Trust Building,
Honolulu, T.H.

For the Defendant, Agnes M. Kanne, etc.,

INGRAM M. STAINBACK,
United States Attorney,
District of Hawaii,
Federal Building,
Honolulu, T.H.

In the United States District Court
For the Territory of Hawaii

Civil Action No. 419

AMERICAN FACTORS, LIMITED, an Hawaiian corporation,

Plaintiff,

vs.

FRED H. KANNE, Collector of Internal Revenue of the United States for the District of Hawaii,

Defendant.

COMPLAINT

To The Honorable United States District Court for the Territory of Hawaii:

Comes now American Factors, Limited, an Hawaiian corporation, Plaintiff, and complaining of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii, Defendant, for cause of action alleges as follows:

1. That American Factors, Limited, Plaintiff above named, is a corporation incorporated under the laws of the Territory of Hawaii, having its principal office in Honolulu, City and County of Honolulu, Territory of Hawaii, and Fred H. Kanne, Defendant above named, is now and at all times since on or about August 1, 1933, has been Collector of Internal Revenue of the United States for the District of Hawaii and is a resident of said Honolulu; and that Plaintiff claims of Defendant the

sum of $97,134.90 with interest on $80,254.41 thereof from December 30, 1937, and on $16,880.49 from October 26, 1938, representing income taxes and interest thereon erroneously and illegally exacted from Plaintiff by Defendant as hereinafter more fully appears.

2. That when the United States entered the World War, H. Hackfeld & Company, Limited, an Hawaiian corporation, which was then conducting and had conducted for many years past a sugar plantation agency, general merchandise store and other businesses, and which was a large factor in the Hawaiian sugar industry and in other businesses in the Territory of Hawaii, was controlled by German interests. The Alien Property Custodian of the United States, through the seizure of German-owned stock, gained control, directly or indirectly, of approximately 68% of the capital stock of H. Hackfeld & Company, Limited.

3. The Alien Property Custodian sought and received the views of many leading business men interested in the sugar industry and in other businesses concerning what was to be done with the H. Hackfeld & Company business, and determined that the business should be continued as a unit and as a going concern and that it must be wholly Americanized. To accomplish these ends, the Alien Property Custodian prescribed a unified plan for the continuance of the business of H. Hackfeld & Company, Limited, in and by a successor corpora-

tion, American Factors, Limited, and for the complete Americanization of that business. As an integral part of the Alien Property Custodian's plan, American Factors, Limited, Plaintiff herein, was created and had a capital stock of $5,000,000.00, divided into 50,000 shares of the par value of $100.00 each, which shares, pursuant to said plan, were issued to H. Hackfeld & Company, Limited, and were transferred to trustees to hold until three years after the expiration of the War, and trust certificates representing and entitling the holders thereof to receive all said shares upon the termination of the trust were sold to bona fide and loyal American citizens or American corporations at a price of $150.00 for each share, or a total stated consideration of $7,500,000.00. Also as an integral part of this plan and in order that the same could be effectuated, a large number of persons who were later joined as defendants and respondents in the Hackfeld litigation hereinafter mentioned became and were officers and agents of H. Hackfeld & Company, Limited, or of American Factors, Limited. Some 23 persons and corporations signed a joint subscription agreement under which each individually subscribed for trust certificates representing a certain number of shares of American Factors, Limited. This joint subscription, which was for 27,000 shares, was conditioned upon this group collectively being allotted 25,000 shares. The joint subscription was accepted for a total of 25,000 shares and trust certificates were issued to and paid for by the said signers of the joint subscription for

the total of said 25,000 shares. Trust certificates representing the other 25,000 shares were issued to and paid for by approximately 615 other persons and corporations. In accordance with the plan, the total stated consideration of $7,500,000.00, representing the purchase price of the trust certificates for the 50,000 shares, was duly paid in cash or United States bonds at par to H. Hackfeld & Company, Limited, and all of its assets and business as a going concern were on August 20, 1918, conveyed to American Factors, Limited, which assumed all liabilities of H. Hackfeld & Company, Limited, and of the business and Plaintiff thereafter continued the business as a going concern.

4. That about June, 1924, Plaintiff's directors were informed that some of the former stockholders of H. Hackfeld & Company, Limited, then dissolved, threatened to initiate litigation. At that time it was not known what form the litigation would take nor who would be the defendants. Plaintiff's Board of Directors considered the matter and authorized and instructed its President to take the necessary steps to secure counsel for Plaintiff in order to prepare for and conduct the defense in the threatened litigation. Plaintiff secured the services of prominent attorneys to represent it in the litigation.

5. That prior to the filing of the complaint in the Hackfeld litigation hereinafter mentioned, it was rumored that the 23 persons and corporations who had joined in the joint subscription agreement

referred to in paragraph 3 hereof were to be charged with fraud in connection with their participation as officers, agents, subscribers or in some other manner, in the transactions. Under these circumstances and prior to the filing of any suit, 21 of the 23 (two being dead) of those persons and corporations who had signed the joint subscription agreement agreed between themselves to prorate expenses of litigation if joined as defendants on an original per-share basis. Plaintiff was not a party to this agreement.

6. The suit of J. C. Isenberg, et al., Plaintiffs, Complainants (hereinafter called "Hackfeld Plaintiffs") vs. George Sherman . . . American Factors, Limited, et al., Defendants, Respondents (hereinafter called "Hackfeld Defendants"), and which litigation is herein called the "Hackfeld Litigation" was commenced in August, 1924. American Factors, Limited, was one of the defendants named in the Hackfeld Litigation and the 23 corporations and persons (including the representatives of the estates of the two deceased persons who had signed the joint subscription agreement) were joined as Hackfeld Defendants. The Alien Property Custodian was made a defendant, and there were some defendants named who the plaintiffs alleged should really have joined as coplaintiffs.

7. The Hackfeld Litigation was brought in equity and the complaint in the action filed in California was entitled "Complaint for Accounting, Relief

against Fraud and Conspiracy, for Damages and Incidental Relief." The gist of the complaint affirmed the sale and transfer of the assets of H. Hackfeld & Company, Limited, to American Factors, Limited, and alleged that the sale and transfer were the result of conspiracy, collusion and fraudulent connivance on the part of certain of the Hackfeld Defendants whereby they caused to be sold to American Factors, Limited, the assets and profitable business of H. Hackfeld & Company, Limited, at a price far below its alleged intrinsic value in fraud of and to the financial injury of the Hackfeld Plaintiffs. The object of the suit was to claim damages in the amount of $10,000,000.00 against American Factors, Limited, and the other Hackfeld Defendants (except the nominal defendants) and that American Factors be ordered by the court to hold all of the assets and business which it had received from H. Hackfeld & Company, Limited, subject to the satisfaction of any judgment which was obtained by the Hackfeld Plaintiffs in the suit. In addition, a claim for $2,500,000.00 damages was made against American Factors, Limited, alone. The Hackfeld Plaintiffs prayed that judgment be entered against American Factors, Limited, together with the other Hackfeld Defendants (except the nominal defendants) in favor of the Hackfeld Plaintiffs for such sum as the court might find them entitled to receive, and also that judgment be entered against American Factors, Limited, specifically for such amount as the court might find the

Hackfeld Plaintiffs had been injured by the alleged mismanagement and alleged breach of fiduciary duties alleged in the complaint to have been committed by American Factors, Limited, because of the acts of its officers or agents.

8. The attorneys employed by American Factors, Limited, investigated the facts and matters pertaining to the Hackfeld Litigation and prepared a joint answer on behalf of American Factors, Limited, and the other Hackfeld Defendants, except the Alien Property Custodian and the nominal defendants, and signed and filed the answer on behalf of such Hackfeld Defendants. The case went to trial and was on trial in the Superior Court of the State of California at San Francisco for many months. At its conclusion the trial judge filed a terse memorandum substantially stating that he was of the opinion, among other things, that (1) no actual fraud on the part of the Hackfeld Defendants was shown, and (2) no constructive fraud existed. Findings of fact were prepared by counsel, approved by the court, and judgment for the Hackfeld Defendants was entered on January 31, 1927.

9. The Hackfeld Plaintiffs in due course perfected an appeal to the Supreme Court of the State of California where further hearings and arguments were had in the matter on appeal. The California Supreme Court rendered its opinion on April 30, 1931 (298 Pac. 1004-1026) sustaining the findings of the trial court, and held that the Hackfeld Plaintiffs

were not entitled to damages or any other relief. Thereafter, a petition for rehearing was filed and denied; and thereafter in the year 1931 a petition was filed by the Hackfeld Plaintiffs praying that the remittitur be recalled and that the case be reconsidered. The Supreme Court of the State of California held in an opinion rendered January 29, 1932, that the remittitur was not to be recalled. The Hackfeld Litigation was terminated in the year 1932 when the final decision in that cause was rendered in said year 1932.

10. American Factors, Limited, paid from time to time all of the expenses of the Hackfeld Litigation which totaled $568,607.76. These outlays were carried by American Factors, Limited, on its records as deferred items. In the early part of the Hackfeld Litigation and by about the end of the year 1925 and many years before there was any final determination of the Hackfeld Litigation, substantially all of the total amount of the expenses then incurred, to wit, expenses totaling the sum of $396,812.50, were prorated among 22 of the Hackfeld Defendants who were charged with fraud and conspiracy in the Litigation proportionately to their original stock holdings in American Factors, Limited, and these 22 Hackfeld Defendants by about the end of the year 1925 paid to American Factors, Limited, said sum of $396,812.50 on account of litigation expenses, but the question as to whether or not these Hackfeld Defendants or American Factors, Limited, would ultimately pay these expenses was not then deter-

mined. The other approximately 615 original stockholders of American Factors, Limited, paid no part of the Hackfeld Litigation expenses. In the calendar year 1932, American Factors, Limited, paid $87,992.50 (which was a part of the total sum of $568,607.76) as expenses for the conclusion of the Hackfeld Litigation; and also, after the final conclusion of the Hackfeld Litigation and in the year 1932, paid on account of Hackfeld Litigation expenses the said sum of $396,812.50 to those Hackfeld Defendants who had theretofore paid the same to Plaintiff.

11. The Hackfeld Litigation was litigation in which the Hackfeld Plaintiffs claimed damages for alleged conspiracy and fraudulent and tortious acts, which came to a final conclusion in the calendar year 1932, and in which the final judgment was that no actual fraud was shown and no constructive fraud existed, and the Hackfeld Plaintiffs were wholly unsuccessful and the Hackfeld Defendants were wholly successful in this Litigation.

12. If the court had ultimately held in the Hackfeld Litigation that certain of the Hackfeld Defendants other than American Factors, Limited, were guilty of conspiracy and fraudulent and tortious acts and such acts of other Hackfeld Defendants resulted in a judgment being procured against all of the Hackfeld Defendants, including American Factors, Limited, because of its constructive liability for the acts of the others, then and in that event

the conspiracy, fraudulent and tortious acts of the other Hackfeld Defendants would have been the proximate cause of an injury to American Factors, Limited, and as between American Factors, Limited, and the other Hackfeld Defendants American Factors would have a good and enforcible cause of action against said other Hackfeld Defendants for the whole of the legal expenses expended by American Factors, Limited, in defense of that suit. The question concerning this possible liability could not be finally determined until the conclusion of the litigation in 1932.

13. The court in the Hackfeld Litigation determined in proceedings which became final in the year 1932 that there was no fraud and no conspiracy and as all acts complained of were for the benefit of and done in connection with the business of American Factors, American Factors, Limited, became liable in the year 1932 and was liable in such year, either in law or in equity, as between itself and the other Hackfeld Defendants to pay all of the costs and expenses of defending the Hackfeld Litigation, and the whole amount of the same, to wit, the sum of $568,607.76 accrued and became and was an allowable deduction from Plaintiff's gross income for the calendar year 1932 for the purpose of computing its net income under the Revenue Act of 1932.

14. That on or about February 21, 1931, Plaintiff made a loan of $50,000.00 to Henry Waterhouse

Trust Company, Limited, an Hawaiian corporation, and received the note of that corporation in the principal sum of $50,000.00 as evidence of said debt. The debt was payable out of assets of Henry Waterhouse Trust Company, Limited, after other liabilities incurred or to be incurred were paid in full. At the time the loan was made, Plaintiff expected to receive payment of the same. In July, 1932, after full investigation and after reappraisal of the assets of Henry Waterhouse Trust Company, Limited, had been made, Plaintiff determined that said debt of $50,000.00 became worthless in 1932 and charged off on its books the amount of $50,000.00 on account of this indebtedness in the year 1932.

15. That during the calendar year 1932, Plaintiff paid the total sum of $4,063.33 to widows and children of deceased employees, which amount was paid as additional compensation for services rendered by employees prior to their death and constituted reasonable compensation for services rendered; that Plaintiff had for the year 1932 and continuously for many years prior thereto a policy of making payments to the widows and children of deceased employees, which payments were voluntary and were determined by Plaintiff's Board of Directors which considered, in determining the amount of the pension, the requirements of the widows and children and the length and value of the service of the deceased employee; that this policy was well-known to Plaintiff's employees, and it is reasonable to assume that the employees considered all such pay-

ments made as an additional reward for faithful service to the company; that such payments made in the year 1932 constituted reasonable additional compensation for services rendered by employees and were an ordinary and necessary business expense which accrued during the year 1932.

16. That on or before March 15, 1933, Plaintiff filed in the office of the Collector of Internal Revenue of the United States for the District of Hawaii at Honolulu, Territory of Hawaii, its income tax return for the calendar year 1932, which return showed that no amount was due and payable by said Plaintiff on account of income taxes for income received during the calendar year 1932; that in said return Plaintiff deducted as ordinary and necessary business expenses accrued during the calendar year 1932 the said sum of $568,607.76 for Hackfeld Litigation costs and expenses, and also deducted the sum of $50,000.00 on account of said bad debt of Henry Waterhouse Trust Company, Limited, and also deducted the sum of $4,063.33 so paid as pensions to widows and children of former deceased employees.

17. That Plaintiff prepared and filed its income tax returns on the calendar-year and accrual bases for the year 1932 and for prior years.

18. That a representative of the Commissioner of Internal Revenue made an examination of said return for the calendar year 1932 and proposed the disallowance of certain deductions claimed by it,

and asserted that an income tax was due from Plaintiff, to which proposed disallowance of deductions Plaintiff protested within the time and in the manner as prescribed by law and the Regulations.

19. That thereafter the Commissioner of Internal Revenue reviewed the matter and tentatively determined that Plaintiff was subject to an income tax for the calendar year 1932 and Plaintiff protested the grounds and conclusions of the Commissioner in that behalf within the time and in the manner as prescribed by law and the Regulations.

20. That thereafter by letter dated September 3, 1937, symbols: IT:E:7-8 GVR-90D, addressed to Plaintiff, the Commissioner of Internal Revenue stated that the determination of the income tax liability of Plaintiff for the calendar year 1932 disclosed a deficiency of $62,438.82; that in and by said letter said Commissioner disallowed as a deduction all but $87,992.50 of the Hackfeld Litigation expenses and stated that of the amounts paid by Plaintiff on account of the Hackfeld Litigation expenses, only the amount of $87,992.50 accrued during the year 1932. The Commissioner also disallowed as a deduction said bad debt deduction in the sum of $50,000.00, but the Commissioner allowed as a deduction said sum of $4,063.33 paid as pensions to widows and children of deceased employees.

21. That thereafter the amount of $62,438.82 as and for an income tax for the calendar year 1932 was assessed against Plaintiff, and Defendant above

named demanded that Plaintiff pay the same, together with an additional amount of $17,815.59 as interest thereon; that said tax and interest totaling $80,254.41 was paid by Plaintiff to Defendant on December 30, 1937.

22. That the whole amount of such claimed income tax so paid resulted from the disallowance as a deduction from its gross income of Hackfeld Litigation expenses in the sum of $480,615.26 and from the disallowance as a deduction from its gross income as a bad debt of the said sum of $50,000.00 which Plaintiff determined to be worthless and wrote off its books in the calendar year 1932.

23. That on or about April 5, 1938, Plaintiff filed with the Commissioner of Internal Revenue through the Collector of Internal Revenue, his agent for that purpose, a claim for refund (a copy of which is attached hereto and marked Exhibit "A") covering the calendar year 1932 on Form 843, as prescribed by the Commissioner of Internal Revenue, for the refund of said $80,254.41, which claim was rejected by the Commissioner on or about December 2, 1938.

24. That by letter dated June 29, 1938, the Commissioner of Internal Revenue stated that the determination of the income tax liability of Plaintiff for the calendar year 1932 disclosed an additional deficiency of $12,657.68, and this additional claimed deficiency resulted wholly from the Commissioner reversing his prior determination that (a) $87,-992.50 of the Hackfeld Litigation expenses accrued

during the year 1932 and was an allowable deduction, and (b) that the total sum of $4,063.33 paid as pensions was an allowable deduction.

25. That on June 29, 1938, the additional amount of $12,657.68 as and for an additional income tax for the calendar year 1932 was assessed against Plaintiff and Plaintiff received from Defendant a demand for payment of the same, together with an additional amount of $4,222.81 as interest thereon; that Plaintiff paid said tax and interest totaling $16,880.49 to Defendant on October 26, 1938.

26. That on or about December 22, 1938, Plaintiff filed with the Commissioner of Internal Revenue through the Collector of Internal Revenue, his agent for that purpose, a claim for refund (a copy of which is attached hereto and marked Exhibit "B") on Form 843, as prescribed by the Commissioner of Internal Revenue, for the additional amount of $16,880.49 so paid by Plaintiff to Defendant on October 26, 1938; that more than six months have elapsed since the filing of said claim and the Commissioner has neither accepted nor rejected the same.

27. That no amount has been paid to said Plaintiff on account of said two sums totaling $97,134.90 claimed as taxes and interest thereon and so illegally assessed, demanded and collected by said Defendant from said Plaintiff.

Wherefore, Plaintiff demands judgment against

Defendant in the sum of $97,134.90 with interest on $80,254.41 thereof from December 30, 1937, and with interest on $16,880.49 thereof from October 26, 1938.

Dated: Honolulu, T.H., this 6th day of January, 1940.

/s/ U. E. WILD,
Attorney for Plaintiff.

Of Counsel:
SMITH, WILD, BEEBE & CADES.

Territory of Hawaii,
City and County of Honolulu—ss.

Comes now S. M. Lowrey who, being first duly sworn, on oath deposes and says:

That he is Treasurer of American Factors, Limited, Plaintiff named in the foregoing Complaint; that said Plaintiff has authorized the signing and filing of the foregoing Complaint; that he has read the foregoing Complaint and that the matters and things therein stated are true to the best of his knowledge and belief.

/s/ S. M. LOWREY.

Subscribed and sworn to before me this 6th day of January, 1940.

[Seal] /s/ ABRAHAM K. KEKIPI,
Notary Public, First Judicial Circuit, Territory of Hawaii.

EXHIBIT "A"

Claim

Form 843
Treasury Department
Internal Revenue Service

To Be Filed With the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

☐ Refund of Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate or income taxes).

[Collector's Stamp]: Collector of Internal Revenue Received Apr. 5, 1938, Honolulu, Hawaii.

Territory of Hawaii,
City and County of Honolulu—ss.

Name of taxpayer or purchaser of stamps American Factors, Limited.

Business address Fort and Queen Streets, Honolulu, Territory of Hawaii.

Residence.....

The deponent, being duly sworn according to law, deposes and says that this statement is made on

behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed Collection District of Hawaii.
2. Period (if for income tax, made separate form for each taxable year) from January 1, 1932, to December 31, 1932.
3. Character of assessment or tax Income tax.
4. Amount of assessment, $80,254.41; dates of payment December 30, 1937.
5. Date stamps were purchased from the Government.....
6. Amount to be refunded Tax and Interest $80,254.41.
7. Amount to be abated (not applicable to income or estate taxes) $.....
8. The time within which this claim may be legally filed expires, under Section 322(b)(1) of the Revenue Act of 1932, on December 30, 1939.

The deponent verily believes that this claim should be allowed for the following reasons:

See statement attached hereto and made a part hereof, pages 1 to 17, inclusive.

[Pages 20 to 37 of printed record.]

AMERICAN FACTORS,
LIMITED,

By /s/ S. M. LOWREY,
Its Treasurer.

Sworn to and subscribed before me this 5th day of April, 1938.

[Seal] /s/ ABRAHAM K. KEKIPI,
Notary Public, First Judicial Circuit, Territory of Hawaii.

Reasons for Allowing the Claim of American Factors, Limited, for Refund of Income Tax Paid for the Calendar Year 1932, and Forming a Part of Its Claim for Refund on Form 843

American Factors, Limited, hereinafter called the "Taxpayer," filed an income tax return in the office of the Collector of Internal Revenue at Honolulu, Territory of Hawaii on or before March 15, 1933, for the calendar and taxable year 1932; said income tax return, hereinafter called the "Return," showed that no amount was due and payable by said Taxpayer on account of income taxes for income received during the calendar year 1932. A representative of the Commissioner of Internal Revenue made an examination of the said Return for the calendar year 1932 during the year 1934, and in and by his report dated September 6, 1934, proposed the disallowance of certain deductions, etc., and asserted that the total income tax liability of said Taxpayer for the calendar year 1932 was the sum of $51,270.97.

On or about March 30, 1935 (within the time lawfully granted to said Taxpayer to file such protest) said Taxpayer filed with the Internal Revenue Agent in Charge its protest dated March 29, 1935, to the

proposal to assess the amount of $51,270.97 or any amount as a claimed additional Federal income tax for the calendar year 1932.

By his tentative deficiency letter dated April 14, 1937, Symbols: IT:E:7-8 GVR, addressed to American Factors, Limited, Honolulu, Territory of Hawaii, the Commissioner of Internal Revenue stated that Taxpayer's net income as corrected for the calendar year 1932 was $459,684.38, and tentatively determined that Taxpayer was subject to an additional income tax in the sum of $63,206.60 for the calendar year 1932.

On or about May 29, 1937 (within the time granted lawfully to said Taxpayer to file a protest to said deficiency letter dated April 14, 1937) said Taxpayer filed a protest dated May 28, 1937, to the assessment of any additional tax against the Taxpayer as and for an income tax for the calendar year 1932.

By letter dated September 3, 1937, Symbols: IT:E:7-8 GVR 90D, addressed to American Factors, Limited, Honolulu, Territory of Hawaii, the Commissioner of Internal Revenue stated that the determination of the income tax liability of Taxpayer for the taxable year ended December 31, 1932, disclosed a deficiency of $62,438.82, as shown in the statement attached to said letter. In said statement Taxpayer's net income as corrected was stated to be the sum of $454,100.54.

Thereafter the amount of $62,438.82 as and for an income tax for the year 1932 was assessed against Taxpayer, and Taxpayer received a demand from

the Collector of Internal Revenue for the District of Hawaii for payment of the same, together with the additional amount of $17,815.59 as interest thereon; said tax and interest totaling $80,254.41 was paid to the Collector of Internal Revenue for the District of Hawaii by Taxpayer on December 30, 1937.

The whole income tax claimed in said letter dated September 3, 1937, and so assessed and paid by Taxpayer results from (a) the disallowance as a deduction of Hackfeld Litigation expenses in the sum of $480,615.26, and (b) the disallowance as a deduction as a bad debt of the sum of $50,000.00 loaned to Henry Waterhouse Trust Company, Limited, which the Taxpayer determined to be worthless and wrote off its books in the calendar year 1932.

Taxpayer contends that the Commissioner erred in disallowing these claimed deductions.

I.

Taxpayer is entitled to a deduction for the calendar year 1932 of all of the Hackfeld Litigation expenses.

At the time of the entrance of the United States into the World War, H. Hackfeld & Company, Limited, an Hawaiian corporation, which then was conducting and for many years past had conducted a sugar plantation agency, general merchandise and other businesses, was controlled by German interests. This corporation was a large factor in the Hawaiian

sugar industry and in other businesses in the Territory of Hawaii. The Alien Property Custodian of the United States seized the German owned stock in the company and in a holding company which owned a large block of the stock in the company, and thereby gained control, directly or indirectly, of about sixty-eight per cent of the stock of H. Hackfeld & Company, Limited.

After thoroughly considering the problems involved, the Alien Property Custodian determined that the business should be continued as a unit and as a going concern, and of course that it must be wholly Americanized. To accomplish these ends, the Alien Property Custodian prescribed a unified plan for the continuance of the business of H. Hackfeld & Company, Limited, in and by a successor corporation, American Factors, Limited, and for the complete Americanization of that business, which plan was completely effectuated. As an integral part of the Alien Property Custodian's plan, American Factors, Limited, Taxpayer herein, was created and had a capital stock of $5,000,000.00, divided into 50,000 shares of the par value of $100.00 each, which shares, pursuant to the plan of the Alien Custodian, were sold to bona fide and loyal American citizens or American corporations at a price of $150.00 each, or a total stated consideration of $7,500,000.00 which was paid to H. Hackfeld & Company, Limited, and all assets and business as a going concern of H. Hackfeld & Company, Limited, were on August 20, 1918, conveyed to

American Factors, Limited, which assumed all liabilities of H. Hackfeld & Company, Limited, and of the business, and thereafter continued the business.

Also, as an integral part of this plan and in order that the same could be effectuated, a large number of persons (who were later made Defendants in the Hackfeld Litigation hereinafter mentioned) became and were officers or agents of H. Hackfeld & Company, Limited, or of American Factors, Limited.

Some twenty-three persons and corporations signed a subscription agreement under which each individually subscribed for a certain number of shares of American Factors, Limited, which totaled 27,000 shares, and the whole subscription was conditioned upon the group collectively being allotted at least 25,000 shares. This joint subscription was accepted for a total of 25,000 shares. The other 25,000 shares were subscribed by approximately 634 other persons and corporations. The Alien Property Custodian knew and approved of the joint subscription and the allotment of 25,000 shares to its members was exactly what he desired because it insured to Taxpayer and to the other 634 odd subscribers stability, credit, leadership and skilled and experienced management.

About June, 1924, the directors of American Factors, Limited, were informed that some of the former stockholders of H. Hackfeld & Company, Limited (then dissolved) threatened to initiate litigation. At that time it was not known what form

the litigation would take nor who would be defendants. The Board of Directors of American Factors, Limited, considered the matter and authorized and instructed its president to take the necessary steps to secure counsel for Taxpayer in order to prepare for and conduct a defense in the threatened litigation. The services of Mr. Oscar Sutro, of San Francisco, a very eminent attorney, were secured by Taxpayer shortly thereafter and other eminent attorneys were subsequently engaged to assist him in the threatened litigation.

It was rumored that the twenty-three persons and corporations who had joined in the joint subscription were to be charged with fraud in connection with their participation as officers, agents or subscribers, etc., in the transactions. Under these circumstances and prior to the filing of any suit, twenty-one of the twenty-three (two being dead) of those persons and corporation that had signed the joint subscription agreement agreed between themselves to prorate expenses of litigation, if joined as defendants, on an original subscription per share basis. American Factors, Limited, was not a party to this agreement.

The suit of J. C. Isenberg, et al., Plaintiffs, Complainants, hereinafter called "Plaintiffs," vs. George Sherman . . . American Factors, Limited, et al., Defendants, Respondents, hereinafter called "Defendants," and which litigation is herein called the "Hackfeld Litigation," was commenced in August, 1924. American Factors, Limited, Taxpayer

herein, was one of the Defendants named in the suit and the twenty-three corporations and persons (including the estates of two deceased) that had signed the joint subscription agreement were joined as Defendants, the Alien Property Custodian was made a Defendant, and there were some Defendants named whom Plaintiffs alleged should really have been joined as coplaintiffs.

The complaint was an action in equity and was entitled "Complaint for Accounting, Relief against Fraud and Conspiracy, for Damages and Incidental Relief." The gist of the complaint affirmed the sale and transfer of the assets of H. Hackfeld & Company, Limited, to Taxpayer and alleged that the sale and transfer were the result of conspiracy, collusion and fraudulent connivance on the part of certain of the Defendants whereby they caused to be sold to American Factors, Limited, the assets and profitable business of H. Hackfeld & Company, Limited, at a price far below its alleged intrinsic value, in fraud and to the financial injury of Plaintiffs. The object of the suit was to claim damages in the amount of $10,000,000.00 against Taxpayer and other Defendants, and that Taxpayer be ordered by the court to hold all of the assets and business which it had received from H. Hackfeld & Company, Limited, subject to the satisfaction of any judgment which was obtained by Plaintiffs in the suit. In addition, a claim for $2,500,000.00 was made against Taxpayer alone. Plaintiffs prayed that judgment be entered against Taxpayer, together with other

Defendants, in favor of Plaintiffs for such sum as the court might find Plaintiffs entitled to, and also that judgment be entered against Taxpayer specifically for such amount as the court might find Plaintiffs had been injured by the alleged mismanagement and alleged breach of fiduciary duties alleged to have been committed by Taxpayer.

The attorneys employed by Taxpayer investigated the facts and matters pertaining to the litigation and prepared a joint answer on behalf of Taxpayer and other Defendants and signed the answer on behalf of such Defendants. The case went to trial and was on trial in the Superior Court of the State of California at San Francisco for many months. At the conclusion of the trial, the trial judge filed a terse memorandum substantially stating that he was of the opinion, among other things, that (1) no actual fraud on the part of Defendants was shown, and (2) no constructive fraud existed. Findings of fact were prepared by counsel, approved by the court and judgment for Defendants was entered on January 31, 1927.

The Plaintiffs in due course perfected an appeal to the Supreme Court of the State of California where further hearings and arguments were had in the matter on appeal. The California Supreme Court rendered its opinion on April 30, 1931 (298 Pac. 1004-1026) sustaining the findings of the trial court which were in favor of Defendants on all points, and held that Plaintiffs were not entitled to damages or any other relief.

Thereafter a petition for rehearing was filed and denied; and thereafter in the year 1931 a petition was filed by Plaintiffs praying that the remittitur be recalled and that the case be reconsidered. The Supreme Court of the State of California held in an opinion rendered January 29, 1932, that the remittitur was not to be recalled and the decision in the case in favor of Defendants became the final decision in the year 1932.

The Hackfeld Litigation was, therefore, litigation in which Plaintiffs claimed damages for alleged conspiracy and fraudulent and tortious acts, which came to a final conclusion in 1932, and in which the final judgment was that no actual fraud was shown and no constructive fraud existed, and the Plaintiffs were wholly unsuccessful and the Defendants were wholly successful.

As it was definitely and finally determined in 1932 that Taxpayer had successfully defended the suit, all expenditures by Taxpayer in connection with the defense of such a suit were, therefore, ordinary and necessary business expenses, which are allowable as deductions to Taxpayer. Kornhauser v. United States (276 U.S. 145), 72 Law Ed. 505, at 506. In that case the Supreme Court held than an expenditure for counsel fees in defending a suit for accounting by a former business partner is deductible as a business expense in computing taxable income. The court states (page 506) that where a suit or action against the Taxpayer is directly connected with or proximately resulted from his busi-

ness, the expense incurred in defending the suit is a business expense which is an allowable deduction within the meaning of the income tax law.

See also The Super-Heater Company, 12 B.T.A. 5, at 11, 12. In that case the amount paid by Taxpayer in compromise of a suit for damages for alleged wrongful cancellation of stock was held to be a business expense and a proper deduction. The authorities are uniform in holding that expenses paid in defending a suit for damages are business expenses and as such are allowable deductions. See Murphy Oil Company, 15 B.T.A. 1195, at 1201.

The Hackfeld case was a suit praying damages for alleged fraudulent and improper acts. The Plaintiffs prayed that all of the property that was acquired by American Factors, Limited, from H. Hackfeld & Company, Limited, should be held answerable to pay and satisfy any judgment for damages which was obtained against any of the Defendants. In addition, a separate claim for damages in the amount of $2,500,000.00 was made against Taxpayer on account of alleged mismanagement of the business. It is obvious that the total cost of the defense of such a suit is an ordinary and necessary business expense of Taxpayer and as such is an allowable deduction under the authorities hereinbefore cited.

Taxpayer paid all of the expenses of the Hackfeld Litigation which totaled $568,607.76. These expenses were carried by Taxpayer on its records as deferred expense items. In the early years of the

litigation and by about the end of the year 1925 and many years before there was any final decision in the Hackfeld Litigation, substantially all of the total amount of the expenses then incurred were prorated among twenty-two of the Defendants who were charged with fraud in the litigation in proportion to their original stockholdings in Petitioner. These twenty-two Defendants had originally acquired a total of 22,675 shares out of the entire 50,000 shares originally issued by Taxpayer. These twenty-two Defendants then and by about the end of the year 1925 paid to Taxpayer the total sum of $396,812.50 on account of the litigation expenses, but the question as to whether or not they or Taxpayer would ultimately pay this expense was not then determined. The other 634 odd stockholders who had originally acquired some 27,325 shares of Taxpayer's stock paid no part of the litigation expenses.

If the court had ultimately held that certain of the Defendants other than Taxpayer were guilty of fraudulent acts and Taxpayer was not, and that such fraudulent acts resulted in a judgment being procured against all the Defendants, including Taxpayer, because of its constructive liability for the acts of the others, then obviously, the alleged fraudulent acts of these other Defendants would have been the proximate cause of an injury to Taxpayer; and as between themselves and Taxpayer, the Taxpayer should legally pay no part of the expenses of defending the suit. For a holding to this effect, see Blackwell Oil and Gas Co. v. Commissioner of In-

ternal Revenue, 60 Fed.(2d) 257. In this case the Taxpayer claimed the deduction as a business expense of an amount which it had paid in settlement of a suit which was predicated upon an alleged conspiracy entered into between the Defendants in the action as directors of the corporation. The court stated at page 258:

"The defendants in the action, as directors of the corporation, had no authority to enter into any unlawful conspiracy. . . . While the alleged acts committed in furtherance of the conspiracy were largely acts committed by the defendants as officers and directors of the corporation, the gist of the action was a conspiracy. It seems clear to us that the petitioner was not liable for the cause of action compromised and the amount paid in compromise was neither an ordinary or necessary expense of the corporation."

In the event that the court had held in the Hackfeld case that the officers and stockholders of the corporation who had acted as agents, officers, etc., in performing the acts complained of had been guilty of performing fraudulent and improper acts, obviously these Defendants would not as agents, officers or directors or otherwise have any authority from American Factors, Limited, to enter into any conspiracy to defraud or to perform fraudulent acts. If the Court had so held, American Factors, Limited, must disavow any liability for the other Defendants' acts and would not as between itself and the other Defendants be legally liable for the

expenses of defending the litigation. But as the court finally determined that there was no fraud and no conspiracy and as all acts complained of were for the benefit of and done in connection with Taxpayer's business, there was an absolute legal liability upon Taxpayer to pay all of these costs of defending such litigation.

A corporation is liable for and may employ its funds in the defense of legal proceedings, even though brought against the officers or members of its committees, etc., where it has an interest in and is affected by the litigation. See Fletcher Cyclopedia Corporations, Permanent Edition, Section 2507.

Mitchell v. Beachy, 202 Pac. 628 (110 Kans. 60). In this case it was held that a corporation—The State Bank of Esbon—had a duty to keep its stock records straight and accurate, and consequently, it could lawfully pay and had a legal obligation to pay all of the attorneys' fees for defending a suit brought against one Richard Beachy, Cashier, of The State Bank of Esbon, and also The State Bank of Esbon and also Richard Beachy personally in which such matter was involved. In that case, as in our case, there were other parties than the defending corporation and the decision of the court sustains as proper the payment of the whole fee for the defense of all parties named as defendants in the suit.

On page 3 of the statement annexed to the ninety-day letter, the following statement is made:

"The record fails to disclose, however, that you were under any obligation to reimburse your co-defendants for the amounts paid by them during the years 1924 and 1925. . . ."

In the year 1932, after final determination of the Hackfeld Litigation, American Factors, Limited, paid the sum of $396,812.50 as payment by itself of expenses of litigation to the codefendants who had paid the same by about the end of the year 1925. In this connection, the facts as shown and the authorities hereinbefore cited show clearly that in 1932, when the Hackfeld case was finally terminated, American Factors, Limited, then for the first time had a legal obligation to the other Defendants to pay all of the expenses of the litigation. This is true, even though there were parties other than the corporation joined as defendants in the litigation, as see Mitchell v. Beachy (supra), Fletcher Cyclopedia Corporations (supra) and other authorities cited. In this case there is no question but that American Factors, Limited, had an interest in and was affected by the litigation, and as stated in Fletcher, Section 2507 (supra), under such circumstances, a corporation is liable for and may employ its funds in the defense of legal proceedings, even though brought against the officers and members of the committee.

It is also a well established rule that any one person or persons who, having an interest in a trust fund (or having an interest in a corporation) at his or their own expense, takes proper proceedings to

save the funds from destruction or to restore the fund is entitled to reimbursement either out of the fund itself or by proportional contribution from those who accept the benefit of his efforts. This is a well established legal and equitable principle. Under this theory of law, as the defense of the suit was wholly successful, the Defendants who contributed toward the payment of fees, etc., are legally and equitably entitled to full reimbursement out of the corporate funds for all of such expenses. This general theory is affirmed in Trustees of the Internal Improvement Fund v. Greenough, 26 Law Ed. 1157 (105 U.S. 527).

This case in the Supreme Court of the United States shows that in 1932, upon the successful conclusion of the Hackfeld Litigation, there arose a definite legal and equitable liability upon American Factors, Limited, in favor of the other Defendants in the suit, to pay all costs and expenses of defending the suit. This is true, even though the corporation or trust is not made a party to the action. It seems as though nothing further should be needed as legal authority upon which to grant the allowance of the claimed deduction.

Further, the total additional amount of the Hackfeld Litigation expenses, to-wit, $171,795.26, Taxpayer contends is also an allowable deduction for the year 1932. The Commissioner in the ninety-day letter states that of the amount paid by Taxpayer only $87,992.50 accrued during the year 1932 and only allowed this sum as a deduction for said year.

Taxpayer is on the accrual basis and the Commissioner apparently contends that the other litigation expenses accrued in prior years. The Commissioner cited Searles Real Estate Trust, 25 B.T.A. 1115 and cases cited therein in this connection.

The Searles case is not in point here because the Searles Real Estate Trust was the only party that could have been obligated to pay the fees which were incurred as absolute obligations in certain years but not paid until a later year because of lack of funds. The question as to whether some other party was liable as between itself and the Searles Trust was not involved.

In United States v. Anderson, 70 Law Ed. 347, at 351 (269 U.S. 422), which was cited in the Searles case, the Supreme Court shows that before an expense or tax has accrued all the events must occur which fix the amount and determine the liability of the taxpayer to pay it.

The final determination as to whether American Factors, Limited, was liable for this litigation expense as between itself and the other Defendants in the case could only be determined at the time that the Hackfeld Litigation was finally concluded in 1932, and it depended upon the final result of that litigation. In this connection, it must not be forgotten that the gravamen of the complaint was that the Defendants other than American Factors, Limited, were guilty of fraudulent and tortious acts as a result of which American Factors, Limited, obtained a benefit. If, as a result of the litigation, it was

finally determined that the other Defendants had performed such fraudulent and improper acts, then as between such Defendants and American Factors, Limited, the fraudulent Defendants and not American Factors, Limited, would be liable for the full amount of all of the Hackfeld Litigation expenses. Under such circumstances, under the rule in United States v. Anderson (supra), American Factors, Limited, could not accrue these expenses until in the year 1932 when the litigation was finally concluded.

II.

Taxpayer is entitled to deduct as a bad debt the amount of $50,000.00 loaned to Henry Waterhouse Trust Company, Limited, and written off in 1932.

On or about February 21, 1931, Taxpayer made a loan of $50,000.00 to Henry Waterhouse Trust Company, Limited, and received the note of that corporation in the principal sum of $50,000.00 as evidence of said debt. The debt was payable out of assets of Henry Waterhouse Trust Company, Limited, after other liabilities incurred or to be incurred by that corporation were paid in full. At the time the loan was made, Taxpayer expected to receive payment of the same.

In July, 1932, Taxpayer was informed by Mr. M. B. Henshaw, Vice President and Manager of Henry Waterhouse Trust Company, Limited, that an exhaustive reappraisal of the assets of that corporation had been made and that the assets did not

have sufficient value to pay the prior claims and that this promissory note was worthless; that the debt of $50,000.00 evidenced by said note was a bad debt and was worthless and that Taxpayer might claim it as a bad debt for the year 1932. Taxpayer determined that the debt became worthless in the year 1932 and charged off the amount of $50,000.00 on account of this indebtedness in the year 1932 and claimed the amount thereof as a deduction in its income tax return.

Taxpayer is informed that the facts occurring subsequent to the year 1932 further bear out the contention that said debt became worthless in the calendar year 1932, and respectfully contends that the deduction is allowable in 1932.

Conclusion

A hearing on this claim for refund is respectfully requested in Washington, D. C. Taxpayer's Attorney and Attorney-in-Fact, Mr. U. E. Wild, is planning to be in Washington, D. C., sometime during the months of May and June, 1938, the exact date of his arrival there not yet being ascertainable. It is respectfully requested that you fix the time of such hearing at approximately such time during the months of May and June as he will hereinafter in writing request.

EXHIBIT "B"

Claim

Form 843
Treasury Department
Internal Revenue Service

To Be Filed with the Collector Where Assessment Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

☐ Refund of Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate or income taxes).

[Collector's Stamp]: Collector of Internal Revenue Received Dec 22, 1938 Honolulu, Hawaii

Territory of Hawaii
County of Honolulu—ss:

Name of taxpayer or purchaser of stamps American Factors, Limited

Business address Fort and Queen Streets, Honolulu, Territory of Hawaii

Residence .....

The deponent, being duly sworn according to law, deposes and says that this statement is made on

behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed Collection District of Hawaii
2. Period (if for income tax, make separate form for each taxable year) from January 1, 1932, to December 31, 1932
3. Character of assessment or tax Income Tax
4. Amount of assessment, $12,657.68; dates of payment October 26, 1938.
5. Date stamps were purchased from the Government .....
6. Amount to be refunded Tax, $12,657.68; interest, $4,222.81 $16,880.49
7. Amount to be abated (not applicable to income or estate taxes) $.....
8. The time within which this claim may be legally filed expires, under Section 322 (b) (1) of the Revenue Act of 1932, on October 26, 1940

The deponent verily believes that this claim should be allowed for the following reasons:

See statement attached hereto and made a part hereof, pages 1 to 9, inclusive.

[Pages 40 to 48 of printed record.]

AMERICAN FACTORS,
LIMITED

[Seal] /s/ S. M. LOWREY
Its Treasurer

Sworn to and subscribed before me this 22nd day of December 1938.

[Seal] /s/ ABRAHAM K. KEKIPI
Notary Public, First Judicial Circuit, Territory of Hawaii.

Reasons for Allowing the Claim of American Factors, Limited, for Refund of Income Tax Paid for the Calendar Year 1932, and Forming a Part of Its Amended Claim for Refund on Form 843.

American Factors, Limited, hereinafter called the "Taxpayer", filed an income tax return in the Office of the Collector of Internal Revenue at Honolulu, Territory of Hawaii, on or before March 15, 1933, for the calendar and taxable year 1932. Said income tax return, hereinafter called the "Return", showed that no amount was due and payable by said taxpayer on account of income taxes for income received during the calendar year 1932. A representative of the Commissioner of Internal Revenue made an examination of the said return for the calendar year 1932 during the year 1934, and in and by his report dated September 6, 1934 proposed the disallowance of certain claimed deductions, etc., and asserted that the total income tax liability of said taxpayer for the calendar year 1932 was the sum of $51,270.97.

On or about March 30, 1935 (within the time granted lawfully to said taxpayer to file such pro-

test), said taxpayer filed with the Internal Revenue Agent in Charge its protest dated March 29, 1935 to the proposal to assess the amount of $51,270.97, or any amount, as a claimed additional Federal income tax for the calendar year 1932.

By his tentative deficiency letter dated April 14, 1937, symbols IT:E:7-8 GVR, addressed to American Factors, Limited, Honolulu, Territory of Hawaii, the Commissioner of Internal Revenue stated that the taxpayer's net income as corrected for the calendar year 1932 was $459,684.38, and tentatively determined that taxpayer was subject to an additional income tax in the sum of $63,206.60 for the calendar year 1932.

On or about May 29, 1937 (within the time granted lawfully to said taxpayer to file a protest to said deficiency letter dated April 14, 1937), said taxpayer filed a protest dated May 28, 1937 to the assessment of any additional tax against the taxpayer as and for an income tax for the calendar year 1932.

By letter dated September 3, 1937, symbols IT:E:7-8 GVR-90D, addressed to American Factors, Limited, Honolulu, Territory of Hawaii, the Commissioner of Internal Revenue stated that the determination of the income tax liability of taxpayer for the taxable year ended December 31, 1932 disclosed a deficiency of $62,438.82, as shown in the statement attached to said letter. In said statement taxpayer's net income as corrected was stated to be the sum of $454,100.54.

Thereafter, the amount of $62,438.82 as and for an income tax for the year 1932 was assessed against taxpayer, and taxpayer received a demand from the Collector of Internal Revenue for the District of Hawaii for payment of the same, together with the additional amount of $17,815.59 as interest thereon. Said tax and interest totaling $80,-254.41 was paid to the Collector of Internal Revenue for the District of Hawaii by taxpayer on December 30, 1937.

Thereafter, on April 5, 1938, taxpayer filed a claim for refund of the entire amount of tax and interest paid, together with a statement attached thereto and made a part thereof.

Thereafter, on June 29, 1938, the amount of $12,-657.68 as and for an additional income tax for the year 1932 was assessed against taxpayer, and taxpayer received a demand from the Collector of Internal Revenue for the District of Hawaii for payment of the same, together with an additional amount of $4,222.81 as interest thereon. Said tax and interest totaling $16,880.49 was paid to the Collector of Internal Revenue for the District of Hawaii by taxpayer on October 26, 1938.

Thereafter, on December 2, 1938, the Commissioner of Internal Revenue sent, by registered mail, a notice of disallowance of the said claim for refund filed April 5, 1938.

The whole income tax claimed in said letters dated September 3, 1937 and June 29, 1938, and so assessed and paid by taxpayer, results from (a)

the disallowance as a deduction of Hackfeld Litigation Expenses in the sum of $568,607.76; (b) the disallowance as a deduction as a bad debt of the sum of $50,000 loaned to Henry Waterhouse Trust Company, Limited, which the taxpayer determined to be worthless and wrote off its books in the calendar year 1932; and (c) the disallowance as a deduction of the amount of $4,063.33 as reasonable, additional compensation for services rendered by employees prior to their death as an ordinary and necessary expense of the business of the taxpayer.

Taxpayer contends that the Commissioner erred in disallowing these claimed deductions.

I.

Taxpayer Is Entitled To a Deduction for the Calendar Year 1932 of All the Hackfeld Litigation Expenses.

The taxpayer incorporates by reference all that portion under the same heading as hereinabove which is included in its statement headed, "Reasons for Allowing the Claim of American Factors, Limited, for Refund of Income Tax Paid for the Calendar Year 1932 and Forming a Part of Its Claim for Refund on Form 843", which is annexed to its claim for refund dated April 5, 1938, which said statement is made a part hereof for all purposes as if fully set forth.

The taxpayer contends that the amount of $87,992.50, which amount was disallowed in the ninety-day letter dated June 29, 1938, and the tax on which

amount is not included in the said claim for refund of April 5, 1938, which has been rejected, is a proper deduction in computing the net income of the taxpayer for the calendar year 1932.

The Commissioner of Internal Revenue, in the ninety-day letter dated September 3, 1937, states that of the amount paid by taxpayer for Hackfeld Litigation Expenses, only $87,992.50 accrued during the year 1932, and accordingly allowed only this amount as a deduction for said year. However, in his ninety-day letter dated June 29, 1938, this amount of $87,992.50 was also disallowed on the ground that it was incurred prior to January 1, 1932. The taxpayer contends that this amount accrued in the year 1932, and, in addition, is deductible for the same reasons as are set forth in its claim for refund dated April 5, 1938.

II.

Taxpayer Is Entitled To Deduct as a Bad Debt the Amount of $50,000 Loaned to Henry Waterhouse Trust Company, Limited, and Written Off in 1932.

The taxpayer incorporates by reference all that portion under the same heading as hereinabove which is included in its statement headed, "Reasons for Allowing the Claim of American Factors, Limited, for Refund of Income Tax Paid for the Calendar Year 1932 and Forming a Part of its Claim for Refund on Form 843", which is annexed

to its claim for refund, dated April 5, 1938, which said statement is made a part hereof for all purposes as if fully set forth.

The claim for refund of the tax on this amount has been disallowed.

III.

Taxpayer Is Entitled to Deduct as an Ordinary and Necessary Expense of Its Business the Amount of $4,063.33, Paid to the Widows and Minor Children of Deceased Employees.

During the calendar and taxable year 1932, taxpayer paid the following amounts to the widows and children of deceased employees: Mrs. R. C. Walker, $1200; minor children of John Frank, $300; minor children of W. Zablan, $240; Mrs. William Searby, $1800; Mrs. Luddecke, $523.33. These amounts were paid as additional compensation for services rendered by employees prior to their death and constituted reasonable additional compensation for the services rendered. This amount was first disallowed as a deduction in the ninety-day letter dated June 29, 1938.

The Commissioner in his deficiency letter held that the amounts paid were gratuities and not deductible as ordinary and necessary business expenses, and cited Law Opinion No. 1040, Cumulative Bulletin No. 3, July-December, 1920, Page 120, in support thereof. This opinion, however, appears to support the contention of the taxpayer, particularly in the following excerpt:

"Even when the pension is granted after the employment has been commenced and without any compulsion, legal or moral, of the employer, it may still fairly be regarded as additional compensation. Employers frequently grant increases of pay to employees who are still in their service without any actual necessity for so doing. Nevertheless, it would be foreign to the ordinary conception of the term 'gift' to regard such increases as gifts. The same may be said of pensions, even when voluntarily granted."

The opinion then goes on to say that it is when pensions are awarded by one to whom no services have been rendered and who has received no direct benefit from the services rendered, that such pensions cannot be regarded as additional compensation.

Article 129, Regulations 77, of the Revenue Act of 1932, provides that:

"When the amount of the salary of an officer or employee is paid for a limited period after his death to his widow or heirs in recognition of the services rendered by the individual, such payments may be deducted."

The taxpayer has for some time had the policy of making payments to the widows and children of deceased employees. The payments made are voluntary and are determined by its Board of Directors, which considers, in determining the amount of the pension, the requirements of the widow and

children and the length and value of the services of the deceased employee.

Mrs. R. C. Walker is the widow of a former treasurer of the company, and she was awarded a pension of $100 per month, beginning July 1, 1920, until further action of the Board.

The minor children of John Frank received, during 1932, $25.00 per month. John Frank had been in the service of the company for twenty-six years prior to his death and was the head packer at the time of his death, and died leaving a widow and five children.

The minor children of W. Zablan received $20.00 per month during 1932. Joseph K. Zablan was in the employ of the taxpayer for thirty years and at the time of his death was foreman of the coffee packing room.

Mrs. Searby received the payment of $150 per month during 1932 and was the widow of a former vice-president of the taxpayer.

Mrs. Luddecke is the widow of an ex-watchman, who was employed for twenty-four years by the taxpayer, and she received a pension of $10.00 per week during 1932.

The company for some time has made it a practice to provide for some payment to the widow and children of its employees upon their death. This policy is well-known to its employees, and it may reasonably be assumed that employees consider such payments as an additional reward for their faithful service to the company. Such payments

constitute reasonable additional compensation for services rendered by employees and are a necessary and ordinary business expense and deductible as such.

Conclusion

It is respectfully submitted that the claim of the taxpayer should be allowed.

[Endorsed]: Filed January 6, 1940.

[Title of District Court and Cause.]

ANSWER

Defendant for his answer to the Complaint herein, by Ingram M. Stainback, United States Attorney for the District of Hawaii, his attorney, respectfully alleges and shows:

1. Denies each and every allegation contained in paragraph 1 of the Complaint, except he admits that American Factors, Limited, is a corporation incorporated under the laws of the Territory of Hawaii, having its principal office in the Territory of Hawaii, City and County of Honolulu, and that Defendant, at all times since August 1, 1933, has been, and still is, Collector of Internal Revenue for the District of Hawaii.

2. The Defendant is without knowledge or information sufficient to form a belief as to the truth of each and every allegation contained in paragraphs 2, 3, 4, 5, 6 and 7.

3. Denies each and every allegation contained in paragraphs 10, 12 and 13 of the Complaint.

4. The Defendant is without knowledge or information sufficient to form a belief as to the truth of each and every allegation contained in paragraph 8 of the Complaint, except he admits that judgment in favor of the Hackfeld defendants was entered on January 31, 1927.

5. The Defendant is without knowledge or information sufficient to form a belief as to the truth of each and every allegation contained in paragraph 9, except he admits that, on April 30, 1931, the California Supreme Court rendered its opinion affirming the judgment of the trial court and that, on January 29, 1932, the Supreme Court of the State of California rendered an opinion holding that the remittur was not to be recalled.

6. The Defendant is without knowledge or information sufficient to form a belief as to the truth of each and every allegation contained in paragraph 11 of the Complaint, except he admits that, in the so-called Hackfeld litigation, the Plaintiffs were wholly unsuccessful and the Defendants were wholly successful.

7. Denies each and every allegation contained in paragraph 14 of the Complaint, except he admits that on or about February 21, 1931, Plaintiff paid or contributed to the Henry Waterhouse Trust Company, Limited, the sum of $50,000, and received from that corporation a note.

8. Denies each and every allegation contained in paragraph 15 of the Complaint, except he admits that during the calendar year 1932 Plaintiff paid the total sum of $4,063.33 to widows and children of deceased employees.

9. Denies each and every allegation contained in paragraph 27 of the Complaint, except he admits that no part of the sum of $97,134.90 has been paid to Plaintiff.

Wherefore, Defendant demands judgment against the Plaintiff dismissing the Complaint with costs.

Dated: Honolulu, T.H., this 14th day of May, 1940.

/s/ INGRAM M. STAINBACK,
United States Attorney,
District of Hawaii.

The receipt of a copy of the within and foregoing Answer is hereby acknowledged this the 14th day of May, 1940.

/s/ U. E. WILD.

Of Counsel:
SMITH, WILD, BEEBE & CADES.

[Endorsed]: Filed May 14, 1940.

[Title of District Court and Cause.]

MOTION TO SUBSTITUTE EXECUTRIX AS DEFENDANT WITH CONSENT OF EXECUTRIX

In the above entitled cause, plaintiff shows that Fred H. Kanne, the above named defendant died on December 24, 1946, and that the Estate of said defendant has passed into the control of Agnes M. Kanne, as Executrix under the Will of said Fred H. Kanne, Deceased, said Agnes M. Kanne having qualified and been confirmed as such Executrix on February 4, 1947, as shown by the records of the Probate Court for the City and County of Honolulu, in the Territory of Hawaii.

Wherefore, plaintiff moves for an order substituting as party defendant herein, Agnes M. Kanne, Executrix as aforesaid, and that otherwise the record in the case may stand as now made and the case proceed on the pleadings and records heretofore filed in said cause.

Dated: Honolulu, T.H., this 3rd day of March, 1947.

SMITH, WILD, BEEBE & CADES,

By /s/ U. E. WILD,
Attorneys for Plaintiff.

It is agreed on behalf of the Estate of Fred H. Kanne, Deceased, that the above motion may be

granted and the substitution made as therein requested.

Dated: Honolulu, T.H. this 5th day of March, 1947.

/s/ RAY J. O'BRIEN,

Attorney for Agnes M. Kanne, Executrix under the Will and of the Estate of Fred H. Kanne, Deceased.

Allowed: March 6, 1947.

/s/ J. F. McLAUGHLIN,
U.S. District Judge.

Memorandum of Authorities

Sec. 58.74, Merten's Law of Federal Income Taxation, Vol. 10, pages 388, 390:

"Sec. 58.74. Suits Against Collectors. An action of assumpsit may be maintained against the collector of internal revenue who has actually collected an income tax. Such an action is personal in nature and therefore it does not abate when the collector's term expires, or upon his death. If the action against the collector has been commenced, his personal representative may be substituted as the defendant. A collector is liable to suit for taxes wrongfully collected even after his resignation or the expiration of his term. An action to recover taxes erroneously collected will not lie against the successor in office of the collector who collected the tax."

(See also cases cited on page 390; footnotes 80 and 81.)

Smietanka v. Indiana Steel Co.,
257 U. S. 1, 66 L. Ed. 99, 42 S.Ct. 1

Page 5: "In Patton v. Brady, 184 U. S. 608, 46 L.Ed. 713, 22 S.Ct. Rep. 493, a suit against a collector, begun after the passage of this statute, it was held that it could be revived against his executrix, which shows again that the action is personal; as also does the fact that the collector may be held liable for interest."

[Endorsed]: Filed March 6, 1947.

[Title of District Court and Cause.]

MOTION TO AMEND ANSWER TO CONFORM TO THE EVIDENCE AND POINTS AND AUTHORITIES

To The Honorable, the Presiding Judge of the United States District Court for the Territory of Hawaii:

Comes now the Defendant and pursuant to Rules 12(h) and 15(b) of the Rules of Civil Procedure moves this Court for leave to amend the Defendant's answer to the complaint herein with respect to the issues hereinafter set forth which issues are now alleged by the Plaintiff herein not to have been raised or denied by the Defendant's original answer to the allegations contained in paragraphs num-

bered XXIII and XXVI of the complaint, to read as follows:

10. The Defendant denies each and every allegation contained in paragraphs numbered XXIII and XXVI of the Complaint and each and every allegation contained in Exhibits "A" and "B" annexed to the Complaint and referred to therein.

11. The Defendant denies each and every allegation contained in the Complaint not hereinbefore specifically admitted or denied.

This motion is based upon the pleadings, the stipulations of facts, and the testimony and documentary evidence adduced at the trial of this action by the parties hereto.

Dated at Honolulu, T.H., this 15th day of November, 1947.

AGNES M. KANNE,

Executrix under the will and of the estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii, Defendant.

By /s/ LELAND T. ATHERTON,
Special Assistant to the
Attorney General.

Of Counsel:

By /s/ RAY J. O'BRIEN,
United States Attorney,
District of Hawaii.

By /s/ EDWARD A. TOWSE,
Assistant U. S. Attorney.

In the District Court of the United States for the Territory of Hawaii

Civil No. 419

AMERICAN FACTORS, LIMITED, an Hawaiian corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix under the will and of the estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii,

Defendant.

POINTS AND AUTHORITIES

The applicable rules of Civil Procedure permitting the defendant to amend her answer are Rules 12(h) and 15(b):

12. "(h) Waiver of Defenses. A party waives all defenses and objections which he does not present either by motion as hereinbefore provided or, if he has made no motion, in his answer or reply, except (1) that the defense of failure to state a claim upon which relief can be granted, and the objection of failure to state a legal defense to a claim may also be made by a later pleading, if one is permitted, or by motion for judgment on the pleadings or at the trial on the merits, . . . The objection or defense, if made at the trial, shall then be disposed of as provided in Rule 15 (b) in the light of any evidence that may have been received."

15. "(b) Amendments to Conform to the Evidence. When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice him in maintaining his action or defense upon the merits. . . ."

Rule 15 enables the case to be litigated on the merits. It permits this by the two methods provided therein. Under subdivision (b) if objection is made to the trial of an issue not raised by the pleadings, an amendment is allowable to raise the issue unless the objecting party shows that it will be actually prejudiced, and even if he makes such a showing (which the plaintiff has not done here) the Court may permit the amendment and grant a continuance so that the objecting party may meet the new issue and thus avoid the prejudice which he would suffer if obliged to litigate the issue at that time. But here, there has been no surprise and

over a period of years in conferences with representatives of the Government and in correspondence with the Government plaintiff failed to make any issue concerning the failure of the defendant in her answer to specifically deny the allegations contained in paragraphs numbered XXIII and XXVI of the Complaint and Exhibits "A" and "B" referred to therein. It is now untimely in the face of defendant's motion to amend its answer to conform to the evidence adduced at the trial with respect to the alleged material allegations of fact contained in the taxpayer's claim for refund of the taxes sought to be recovered in these proceedings.

Scott v. Baltimore & O. R. Co.,
1 F. (2d) 61, 64, (fn. 9);

Rogers v. Union Pac. Ry. Co.,
145 F. (2d) 119, 123 (C.C.A. 9);

Wall v. Brim,
145 F. (2d) 492, 493 (C.C.A. 5);

Advance Aluminum Casting Corp. v. Harrison, 158 F. (2d) 922, 924 (C.C.A. 7);

Lientz v. Wheeler,
113 F. (2d) 767, 769 (C.C.A. 8);

Mishawaka Rubber & W. Mfg. Co. v. Payne & Williams Co.,
139 F. (2d) 603, 606 (C.C.A. 6);

United States v. Cushman,
136 F. (2d) 815, 817 (C.C.A. 9).

By entering into the stipulations of fact, offering them in evidence, and adducing other evidence of the alleged material facts stated in the taxpayer's claims for refund, we submit that any issues not raised by the pleadings with respect to such allegations (if properly deemed to have been made a part of the Complaint herein for all purposes within the terms of Rule 10 (c) of the Rules of Civil Procedure) plaintiff should be deemed to have treated the defendant's answer in all respects as if it had contained a specific denial of said allegations, thus bringing it within the provisions of Rule 15 (b).

Dated at Honolulu, T.H., this 15th day of November, 1947.

Respectfully submitted,
AGNES M. KANNE,

Executrix under the will and of the estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii, Defendant.

By /s/ LELAND T. ATHERTON,
Special Assistant to the
Attorney General.

Of Counsel:

By /s/ RAY J. O'BRIEN,
United States Attorney,
District of Hawaii.

By /s/ EDWARD A. TOWSE,
Assistant U. S. Attorney.

[Endorsed]: Filed November 17, 1947.

In the United States District Court
for the Territory of Hawaii

Civil No. 419

AMERICAN FACTORS, LIMITED, an Hawaiian corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix under the Will of FRED H. KANNE, deceased,

Defendant,

and—Civil No. 474

ALEXANDER & BALDWIN, LIMITED, an Hawaiian corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix under the Will of FRED H. KANNE, deceased,

Defendant.

OPINION OF THE COURT

These two cases for the recovery of income taxes paid to the United States Internal Revenue Collector, were both tried in the same hearing.

The claim of American Factors, Limited was for recovery of taxes paid on sums deducted as exemptions from its 1932 gross income tax return, which exemptions were denied by the Collector, as follows:

(1) In 1924 the corporation, together with 23 of

its stockholders, was sued by J. C. Isenberg, et al., for $10,000,000 damages, alleging fraud in connection with the transfer of the property of Hackfeld & Company, Limited by the Alien Property Custodian to the taxpayer, a newly formed corporation.

Twenty-two of the stockholders who were jointly sued with the taxpayer entered into an agreement among themselves to pay pro rata, on the basis of the stock for which they severally originally subscribed, the litigation costs of this suit. The taxpayer advanced from time to time such costs and expenses as they accrued and rendered accounts to this group of defendant stockholders. This litigation ran for several years and its total cost was $568,607.76. Of this sum, the twenty-two contributing stockholding defendants paid in to the company the sum of $396,812.50. There were 615 other original stockholders who were not made defendants who paid nothing into the litigation fund.

When the litigation came to an end in 1932 the taxpayer, being authorized at a meeting of its stockholders, refunded to the twenty-two stockholding defendants the sums they had contributed and deducted the same from its gross income tax return as an item of litigation expense, claiming it was legally liable to these contributors notwithstanding that they had made no claim or demand. This exemption claim is disallowed.

(2) In 1931 this taxpayer advanced the sum of $50,000 to H. Waterhouse Trust Company, Ltd. in the hope of aiding, with the help of others, the

trust company from closing its doors due to its insolvent condition, which insolvency was known to the taxpayer. The following year the loan was written off the taxpayer's books as a total loss and deducted as a bad debt in its gross income tax return for that year. It claimed that the loan, while somewhat speculative, was made in good faith and supported by a promissory note. The note contained a proviso, as follows:

"Payment of principal and interest to be made only when, if and to the extent that there shall be funds available therefor as set forth in letter of this date from the payor to the payee."

This deduction claim is disallowed.

(3) In its tax return for 1932 the taxpayer deducted as an ordinary and business expense the sum of $4,063.33 paid by it as pensions to widows and children of deceased employees. The collector denied this deduction; the Court finds it justifiable and allowed it.

Alexander & Baldwin, Limited's Case.

The claim of Alexander & Baldwin, Limited was for "bad debt" deduction which had been disallowed, and for a contribution which was also disallowed by the Collector.

In 1931 this taxpayer loaned $50,000 to Henry Waterhouse Trust Company, Limited for the purposes of reorganization, for which it received a note in the same terms as that received by American Factors. The following year this taxpayer deter-

mined the debt to be worthless and wrote it off in its books as a loss, which loss it claimed in its following tax return. This claim was on the same basis as the American Factor's claim and was disallowed by the Court.

In 1932 this taxpayer contributed $1,000 to the Hawaiian Bureau of Government Research, an organization maintained by contributions, which was created to gather statistical information and report on public affairs, legislation, social and economic which affected or might affect taxpayers, which contribution was disallowed by the collector.

At the close of arguments November 15, 1947 in the trial of the two cases the Court announced from the bench the following decisions:

"American Factors, Limited.

1. Hackfeld Litigation:

"My opinion is that the persons who subscribed to pay voluntarily for the defense of this inordinately costly litigation were impulsed and motivated entirely by keen personal interests and desires to defeat the demands of the plaintiffs in the case and clear themselves as defendants against claims that they had unlawfully conspired and acted in fraud and agreed, as well as to escape a liability in damages by a possible judgment against them, and to protect their individual investments as shareholders in the corporation, and that they were willing, and made a definite offer to pay, and did pay, to the extent of assessments made against them, without

promise or original expectation of reimbursement at the time and times they made their contributions to the litigation fund.

"There is no evidence that the taxpayer promised or implied an intention to reimburse them at the time they subscribed the agreement or made their contributions, and no evidence that the taxpayer even considered the matter until the backbone of the litigation was broken in victory to all the defendants.

"There was no demand by them or test of their right to have contribution at the expense of other shareholders who were not named as parties defendant. The approval at a stockholders' meeting and the act of the management in reimbursing these contributors from the company's funds apparently flowed largely from feelings of gratitude arising from the successful outcome of the case in litigation and the liberal aid of the contributors and their steering committee which contributed many facilities and influences such as could not have been supplied by the management of American Factors acting alone.

"Certainly, the taxpayer had very substantial interests to protect, and was justified in every way, as a legitimate business outlay, in paying from its own funds during the taxable year of 1932, or earlier years had it chosen to do so, the costs of litigation which imperiled its existence although others were involved in the same litigation as defendants and had much to lose, had the others not come for-

ward with funds and volunteered to engineer and fight the battle at their own costs and had the taxpayer not accepted this offered payment plan and the volunteered services; either of the parties could have abandoned or modified this plan at any time, but so long as it was adhered to it was binding on both; but the taxpayer was not justified, in the realm of taxation laws and deductibles, to later deduct from taxable income the money it paid to reimburse voluntary contributors for money which they had paid out to clear themselves and this company of fraudulent charges made against them collectively and individually and to protect their property interests, no matter if victory in such defense brought great benefit to the taxpayer as well as to the other named defendants.

"As between share owners, of course, within ultra vires limitations, they were empowered to make any desired distribution of the company's funds so long as none was injured.

"The taxpayer is entitled to an expense-deduction in its 1932 tax return of the sum of all Hackfeld litigation paid by it prior to the end of 1932, less the amount paid in to it for that purpose by the other defendants. The claim for tax refund on sums reimbursed to voluntary contributors to this litigation fund is denied.

2. "As to the Waterhouse Trust Company contribution of $50,000, that was just that—a contribution. The note given in acknowledgement of the contribution was contingent as to value upon such

conditions as to give it no negotiable value from the time it was made It could not be dealt with as a debt. The considerations in payment for the contribution flowed to the payee of the note at the time it was made—the protection of the commercial community, sympathy toward Waterhouse Company clients who could ill afford to lose, and other commendable desires and motives of helpfulness and security, but there was no attempt to show that either American Factors or Alexander & Baldwin would have suffered any material loss had they not attempted to keep the Waterhouse Trust Company a going concern.

"I find that no part of this contribution was deductible as a bad debt or loss in 1932 or at any other time, since it never was a collectible debt, but was from the beginning in the nature of a contingent or speculative gift, to which status it speedily resolved itself with certainty, although it may have accomplished in part the purpose for which it was intended, that is, prolonged the life of Waterhouse Trust Company. Claim for tax refund on this outgoing sum of $50,000 is denied.

3. "As to the items of contributions or pensions to dependents of deceased employees, I am fully convinced from the evidence that this was a usual and, within ordinary business discretion, a necessary and proper business practice. It is well recognized that it would reasonably tend to the gratification, good will and loyalty of employees in general and

thus be a benefit to business operations, particularly in a business under many department heads and of ramified operations.

"I find these moderate and reasonable items to be proper income tax deductions.

"Alexander & Baldwin, Limited.

1. "My opinion and finding with respect to the Waterhouse Trust contribution in the American Factors case is, in all pertinent respects, applicable to the refund claim of this litigant and the said claim is denied.

2. "As to the contribution to maintain the Hawaiian Bureau of Government Research, I find this to be an ordinary and necessary expense to a firm carrying on the business and business trusts and responsibilities such as Alexander & Baldwin carry.

"If more extensive findings and conclusions are desired, the prevailing parties may prepare and submit such proposals to me, after tendering copies to opposing counsel."

/s/ D. E. METZGER,
Judge.

[Endorsed]: Filed March 18, 1948.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

1.

Findings of Fact

Upon the record, testimony and evidence adduced in this case, the Court makes the following findings of fact:

I.

That American Factors, Limited, plaintiff herein, is a corporation organized under the laws of the Territory of Hawaii, with its principal office in Honolulu, City and County of Honolulu, Territory of Hawaii; that at the end of that calendar year and during the entire calendar year 1931 it was agent for thirteen sugar plantations and other corporations located in and carrying on business in the Territory of Hawaii and elsewhere, which corporations, according to their books and annual reports, had a total capital of $26,944,720.00 and a total surplus and undivided profits of $21,411,420.24, or a total capital and surplus as of December 31, 1930, of $48,356,140.24; and that on December 30, 1930, plaintiff and the companies for which it served as agent had on deposit in banks in the Territory of Hawaii at least a total sum of $1,741,696.24.

II.

That Fred H. Kanne was Collector of Internal Revenue of the United States of America for the District of Hawaii and a resident of Honolulu at

all times from on or about August 1, 1933, until his death on December 24, 1946; that Agnes M. Kanne, the duly qualified and appointed Executrix of the Will and of the Estate of Fred H. Kanne, deceased, was substituted as defendant in this cause by order of this Court on March 6, 1947.

III.

That when the United States of America entered the First World War, H. Hackfeld and Company, Ltd., was an Hawaiian corporation which was then conducting and had conducted prior thereto a sugar plantation agency, general merchandise stores, and other businesses and was a large factor in the Hawaiian sugar industry and in other businesses in the Territory of Hawaii; that it had been and was at that time controlled by German interests; that on or about January 28, 1918, and during March 1918, the Alien Property Custodian of the United States of America seized the capital stock of said Hackfeld Company owned by German Nationals and thereby gained control either directly or indirectly of approximately 68½% of its capital stock.

IV.

That prior to January 28, 1918, the business of said Hackfeld Company had been seriously disrupted as a consequence of restrictions placed upon it by the allied governments as a result of its German affiliations and those of its stockholders; that a plan for the reorganization of the company was

formulated in the office of the Alien Property Custodian of the United States of America which contemplated the placing of the ownership and control of the assets and businesses of said Hackfeld and Company, Ltd., wholly in the hands of loyal American citizens, and as a result of which plan the American Factors, Limited, the plaintiff herein, was organized for the express purpose of taking over the business and assets of said H. Hackfeld and Company, Limited, as a going concern, and that as an integral part of said plan the entire capital stock or trust certificates therfor of American Factors, Limited, was to be sold, and was sold, to American citizens familiar with the sugar agency business in the Hawaiian Islands who could properly and efficiently manage its business, and in whom the subscribing public would have confidence; and that to that end it was the desire of the Alien Property Custodian and his plan that a large portion of the trust certificates should be purchased by persons and corporations who were then engaged in the plantation agency business in Hawaii.

V.

That pursuant to the aforesaid plan, trust certificates representing fifty thousand shares of the capital stock of plaintiff were issued and sold for the price of $150.00 a share and a total stated consideration of $7,500,000.00 was duly paid in cash or United States liberty bonds at par to said Hackfeld Company, and in exchange therefor Hackfeld Company

conveyed all of its assets and businesses as a going concern on August 20, 1918, to plaintiff, and plaintiff assumed all liabilities of Hackfeld Company, Limited, and of the business and thereafter continued the business as a going concern.

VI.

That among the subscribers who participated in a joint subscription agreement for trust certificates for twenty-seven thousand shares of stock of the plaintiff corporation were persons who were incorporators of plaintiff and persons who subsequently became its officers and directors and otherwise participated in the business and affairs of plaintiff, to whom an allotment of trust certificates for twenty-five thousand shares of plaintiff was made; that the remaining trust certificates for twenty-five thousand shares of plaintiff's stock were sold to approximately 614 other persons and corporations who did not join in the subscription agreement.

VII.

That in June 1924 the then directors of plaintiff were informed that certain former stockholders of Hackfeld Company, Limited, then dissolved, threatened to initiate litigation, but at that time it was not known what form such litigation would take nor who would be the defendants; that the board of directors of plaintiff authorized its president to secure counsel for it, to prepare for and conduct the defense of plaintiff in the threatened litigation if

plaintiff were named a defendant therein, and plaintiff procured the services of attorneys to represent it in the litigation.

VIII.

That prior to the filing of the suits in the threatened litigation, twenty-one of the twenty-three persons and corporations who had joined in the joint subscription agreement for shares of plaintiff entered into a written agreement on July 28, 1924, to which plaintiff was not a party, wherein they agreed to prorate on an original per share basis the expenses of the threatened litigation if they were joined as defendants therein; that two of the individuals who had joined in the joint subscription agreement for shares of the plaintiff did not participate in the agreement for sharing the expenses of the threatened litigation because they had died.

IX.

That in August and September 1924, identical actions were instituted by J. C. Isenberg et al, plaintiffs, complainants, against Geoorge Sherman and American Factors, Ltd., et al, defendants, respondents, in the Circuit Court of the First Judicial Circuit, Territory of Hawaii, and in the Superior Court of the State of California in and for the City and County of San Francisco; that the suit filed in the California court was the only suit actually tried; that American Factors, Limited, was one of the defendants named in both of said suits and the twenty-three corporations and persons, including the rep-

resentatives of the two deceased persons who had joined in the joint subscriptions agreement for the shares of plaintiff, were joined as defendants; and the Alien Property Custodian of the United States was also made a respondent but no relief or judgment was sought against him.

X.

That the complaint in the aforesaid action which was begun in the Superior Court of the State of California was entitled "Complaint for Accounting, Relief against Fraud and Conspiracy, for Damages and Incidental Relief"; that it affirmed the sale and transfer of the assets of H. Hackfeld and Company, Limited, and alleged "that the sale and transfer [of said assets and businesses] were the result of conspiracy, collusion and fraudulent connivance on the part of certain of the defendants whereby they caused to be sold to American Factors, Ltd. (the taxpayer herein) at a price far below its alleged intrinsic value, in fraud of and to the financial injury of plaintiffs"; that it alleged that the property so transferred was worth $17,500,000.00 and claimed $10,000,000.00 damages, and in addition claimed damages in the amount of $2,500,000.00 against American Factors, Limited, for alleged mismanagement of the business and the assets; that the complaint in said action in substance alleged that American Factors, Limited, took and received all of the assets of H. Hackfeld & Company, Limited, with full knowledge of all of the facts and circumstances set forth in the complaint and with full knowledge of and concerning the rights and equities

of the stockholders of said H. Hackfeld & Company, Limited, and did thereafter handle the said assets and conduct said business in trust for the protection by it of the rights and equities of said stockholders and the complainants; that American Factors did so manage said business and did so improperly handle said assets as to cause great damage to said assets and business and great injury to the rights and equities of said stockholders and complainants; that American Factors was a party to the fraudulent scheme and the conspiracy therein alleged and holds said business and said property in trust to protect the rights and equities of complainants; and that by its mismanagement of said business and said assets, it has caused further and additional losses to said business and to said stockholders of said Hackfeld Company; that among the prayers in the complaint in said action it was prayed that the California court enter its order directing American Factors, Limited, to hold that part and portion of the assets and business belonging to it and representing the interest in said corporation of the respondents in trust for the complainants, subject to the application of said assets to the satisfaction of such judgment as may be entered therein against said respondents, and that it hold all of its said assets subject to their application and such judgment as may be rendered against it; that the California court also enter an order directing the respondents other than American Factors, Limited, to hold their stock in American Factors, Limited,

in trust therein, subject to the application of said stock to the payment of such judgment as may be entered therein against said respondents; that the Court make and enter its judgment against all the respondents, including American Factors, Limited, in such manner as to the Court may seem just and proper and for such an amount as will adequately and completely compensate and reimburse the complainants for the injury, loss and damage suffered by reason of the fraud perpetrated by the respondents; and that the Court do make and enter its judgment against American Factors, Limited for such an amount as it may appear that complainants have been injured by reason of injury to their equity and rights attaching to the property of the corporation through mismanagement and breach of fiduciary duly committed by American Factors, Limited.

XI.

That the attorneys employed by American Factors, Limited, after investigating the facts and matters pertaining to the Hackfeld litigation, prepared a joint answer on behalf of American Factors, Limited, and the other Hackfeld defendants except the Alien Property Custodian and other nominal defendants, and signed and filed their answer on behalf of American Factors, Limited, and the other twenty-three co-defendants named in the Hackfeld suits. A separate answer was filed on behalf of the Alien Property Custodian.

XII.

That on January 6, 1926, the trial judge of the Superior Court of California filed the following memorandum:

"I am of the opinion that (1) no actual fraud on the part of respondents was shown; (2) no constructive fraud existed; (3) the price paid was adequate; (4) the suit is not barred by the Hawaiian statute of limitations; (5) plaintiffs were not guilty of laches. Frank J. Murasky, Judge."

This memorandum is reported in the case of Isenberg v. Sherman, 212 Cal. 454, 461; 298 Pac. 1004. On March 16, 1926, a decision comprising Findings of Fact and Conclusions of Law was filed by the same trial judge, and on January 31, 1927, judgment was entered for the defendants and against the complainants.

XIII.

That an appeal was perfected by the plaintiffs in the aforesaid equity suit (the California case) to the Supreme Court of the State of California, where after further hearings and arguments the California Supreme Court on April 30, 1931, rendered its opinion affirming the judgment of the trial court. The opinion of the Supreme Court of California is reported in 212 Cal. 454, 298 Pac. 1004. On May 28, 1931, the Supreme Court of California denied a petition for rehearing, and thereafter a motion to recall the remittitur issued to the County Clerk of San Francisco was filed by the complain-

ants on August 6, 1931, and the Supreme Court of California on January 29, 1932, denied the complainants' motion to recall the remittitur. The decision of the Supreme Court of California on this motion is reported in 214 Cal. 722, 7 Pac. 2d 1006. On April 25, 1932, the Supreme Court of the United States denied a petition filed by the Hackfeld plaintiffs for a writ of certiorari to the Supreme Court of California, 286 U. S. 547. This terminated all litigation between the parties in the aforesaid suit.

That the Superior Court of the State of California in the aforesaid decision filed on March 16, 1926, among others made the following Findings of Fact:

"XL.

* * *

"The 50,000 fully paid shares of stock of American Factors, Ltd., mentioned in said stockholders resolution and subject to all the terms and conditions thereof, were at the time that they were issued to H. Hackfeld & Co., Ltd., in exchange for the property in this finding referred to, an adequate, just and fair price to H. Hackfeld & Co., Ltd., for all and singular the property, business, rights, contracts, agencies, franchises, credits, accounts and other interests of every kind of said H. Hackfeld & Co., Ltd., and the good will thereof as a going concern, subject to its outstanding debts, obligations and liabilities, incldng income taxes for the year 1918 up to the date of transfer of said property, etc. to said American Factors, Ltd.

* * *

"XLV.

"The defendants did not, nor did any of them, reap any benefits from said reorganization, or from the sale of said stock of American Factors, Ltd., or the trust certificates therefor, or from the purchase thereof by themselves except such benefits as accrued to every purchaser of said trust certificates."

XV.

That American Factors, Limited, from time to time received from its co-defendants in the Hackfeld litigation their pro rata share of the expenses of that litigation and paid all of the expenses of that litigation which totalled $568,607.76, but American Factors carried these payments as deferred items on its accounting records until after the conclusion of that litigation in 1932, when it charged off in that year on its books the entire amount thereof and took the same as a deduction in computing its taxable net income for that year.

In that year, after the conclusion of the Hackfeld litigation, American Factors, Limited, repaid to its co-defendants $396,812.50, representing the total of the amounts so received by it from them during the progress of the litigation. Repayment of the $396,812.50 was authorized by resolution adopted by the board of directors of the plaintiff at a meeting thereof held on March 4, 1932; but the reimbursement to plaintiff's stockholder-co-defendants was wholly voluntary on the part of plaintiff and was not made pursuant to any demand by its said

stockholder-co-defendants, or as a result of a test of their right to have contributions at the expense of other shareholders who were not named as parties defendant in said Hackfeld litigation. There is no evidence that plaintiff promised or implied an intention to reimburse its co-defendants in the Hackfeld litigation at the time they subscribed or made their contributions toward the expense of conducting that litigation, and there is no evidence that plaintiff even considered the matter until the litigation was finally concluded in 1932; and the approval at the stockholders' meeting of plaintiff of the act of its management in reimbursing its stockholder-co-defendants from the company's funds apparently flowed largely from feelings of gratitude arising from the successful outcome of the case in litigation and the liberal aid of the contributors and their steering committee in supplying the many facilities and influences which could not have been supplied by the management of American Factors acting alone.

XVI.

That the twenty-three co-defendants who subscribed to the agreement among themselves to pay voluntarily for the defense of the Hackfeld litigation were motivated entirely by keen personal desires to defeat the demands of the plaintiffs-complainants in the Hackfeld suits and clear themselves as defendants against claims that they had unlawfully conspired and acted in fraud and greed, as well as to escape a liability in damages by possible judgment against them, and to protect their individual

investments as shareholders in the plaintiff corporation; and they were accordingly willing and did make a definite offer to pay, and did pay to the extent of assessments made against them, without promise or original expectation of reimbursement at the time and times they made their contributions to the litigation defense fund.

XVII.

That plaintiff had very substantial interests to protect in defending the Hackfeld litigation which imperiled its existence, and had much to lose had the other co-defendants not come forward with funds and volunteered to engineer and fight the battle at their own cost, and had plaintiff not accepted their offered payment plan and their volunteered services. In its federal income tax return for the taxable year 1932, plaintiff took the entire amount of $568,607.76 of Hackfeld litigation expenses as a deduction in computing its taxable net income, and the Commissioner of Internal Revenue disallowed the entire amount claimed as a deduction.

XVIII.

That the Henry Waterhouse Trust Company, Limited, was incorporated under the laws of the Territory of Hawaii on November 26, 1902, to engage in the business usual and permitted to a trust company under the laws of the Territory. In addition to engaging in the usual fiduciary business common to all trust companies, it operated a planta-

tion agency department, a real estate department, a stock and bond brokerage department, and an insurance department, and at times invested in stocks and bonds to a limited extent on its own account, these various activities being permissible under the Hawaiian statutes and its Articles of Incorporation.

XIX.

That in the middle of October, 1930, the Henry Waterhouse Trust Company increased its capital stock from $200,000.00 to $400,000.00, consisting of four thousand shares of a par value of $100.00 each. The new shares were all taken by old stockholders who paid for them in cash at par. In November of that year, the effects of the general business depression began to be felt in the Territory of Hawaii, and as a large part of the Waterhouse Company assets consisted of real estate and mortgages, its secretary became apprehensive that if many calls were made on its demand accounts the company's financial condition would not be sufficiently liquid to meet its cash requirements. He discussed the situation with the treasurer and auditor of the Company and informed the management of Bishop Trust Company, Limited, that a sale of the Waterhouse stock might be arranged, suggesting a price of $100.00 each or more for the shares, the Bishop Trust Company taking the suggestion under consideration pending an examination of the affairs of the Waterhouse Company.

XX.

In 1931 the Waterhouse Company was conducting business as usual but was encountering some financial difficulties; economic conditions were not clear, and, after an investigation, the executives of the Bishop Trust Company, Limited, advised the Waterhouse Company shareholders that it would not pay cash for their shares as had been previously suggested. Mr. A. W. T. Bottomley, president of American Factors, Limited, and of the Bishop First National Bank of Honolulu, and vice-president of the Bishop Trust Company, Limited, called a conference of the heads of the principal Hawaiian sugar agencies, the president of the Bank of Hawaii, Limited, the president of the Hawaiian Trust Company, Limited, and two members of the finance committee of the Bishop Trust Company, Limited, to present to them the financial condition of the Waterhouse Company and discuss the feasibility of making some plan to prevent the Waterhouse Company from being forced into liquidation.

XXI.

That on Saturday, February 14, 1931, Mr. W. F. Frear, President of the Bishop Trust Company, Limited, at a meeting of the Board of Directors of that Company, made a statement which was recorded on the minutes as follows:

"This is a special meeting called to consider a proposition to take over the Henry Waterhouse Trust Co., Ltd. At first it was a proposition to

purchase the stock of that company, somewhat as we purchased the stock of the Pacific Trust Co., but as a result of investigation, it changed largely to a salvage proposition.

"The plan now is for our Company to acquire all the stock of the Waterhouse Trust Company without cost; for Mr. and Mrs. R. W. Shingle and Mr. A. N. Campbell, in settlement of their indebtedness to the Company, to pay into it $535,000.00 and to convey to its order their respective 18% and 10% undivided interests in certain land, fish ponds and fishery at Kalihi, the same to be sold for $87,000.00 and the proceeds, with $13,000.00 additional contributed by the Bishop Trust Co., to make up an even $100,000.00, to be paid into the Waterhouse Trust Co., making in all $635,000.00 thus paid in. In addition, a number of corporations and individuals are to contribute various sums aggregating $400,000.00, thus making altogether $1,035,000.00 of cash to be paid into the Waterhouse Trust Co. The Bishop Trust Co. is to pay such amount, if any, as may be required in addition to enable the Waterhouse Trust Company to meet its liabilities, but it is hoped that no such contribution will be required. That, however, remains to be seen.

"The Bishop Trust Co. is to take over, without other cost, the business of the Waterhouse Trust Co., other than the assets and liabilities, and to operate such business at its own expense and for its own benefit. This will include the trusts, executorships, agencies, insurance, safe deposit business, etc.,

with the necessary furniture, equipment and supplies therefor. It is hoped also that the Bishop Trust Co., will profit through making new contacts. The stock and bond and real estate departments will probably be discontinued.

"The assets and liabilities of the Waterhouse Trust Co. are to be gradually liquidated by applying the assets to the liabilities, together with the expenses of liquidation, including $1,000.00 a month to be paid to the Bishop Trust Co. for supervision.

"In final settlement, if there is an excess of assets over liabilities, it is to be applied, first, to the reimbursement of the amount, if any, that may be contributed by the Bishop Trust Co. in addition to the $1,035,000.00, and, secondly, pro rata to the contributors of the $400,000.00 with simple interest at 4%, and, thirdly, the balance, if any, to go to the Bishop Trust Co.

"There are three objects: First, to prevent the failure of such a company as the Waterhouse Trust Co., with the consequent general disastrous effects; secondly, to prevent loss on the part of many who have entrusted their money to the Company for investment and who can ill afford the loss; and, thirdly, to enable the Bishop Trust Co. to acquire new business. These three objects naturally appeal with different degrees of force to different groups of contributors."

The plan, as outlined above, was approved by the Board of Directors of the Bishop Trust Company, Limited, at that meeting; and the transactions men-

tioned in the second paragraph of Mr. Frear's statement were duly performed within a few days after February 14, 1931.

XXII.

Prior to the consummation of the transactions hereinbefore mentioned, the following individuals and corporations promised to pay to the Waterhouse Company, upon consummation of the proposed plan, the sums of money set opposite their names, to wit:

Name of Contributor	Amount Paid
The Bishop Company, Limited	$100,000
American Factors, Limited	50,000
Alexander & Baldwin, Limited	50,000
Castle & Cooke, Limited	50,000
W. R. Castle	50,000
Beatrice Castle Newcomb	50,000
Bank of Hawaii	25,000
Hawaiian Trust Company, Limited	25,000
Total	$400,000

XXIII.

That at a meeting of the Board of Directors of American Factors, Limited, held on March 2, 1931, payment of $50,000.00 to the Waterhouse Company pursuant to the aforesaid plan was duly authorized.

XXIV.

That the plan of reorganization of the Water-

house Company was carried out as outlined above and plaintiff and the individuals and other corporations whose names appear above in the preceding paragraph, number XXII of these findings, actually paid into the Waterhouse Company the amounts of money stated opposite their respective names, upon the provisions concerning the repayment thereof as are more particularly stated in the letters from the Henry Waterhouse Trust Company to plaintiff dated February 21, 1931, and February 24, 1931, which read respectively as follows:

"We outline as follows the plan in regard to the Henry Waterhouse Trust Company, Limited.

"1. The Bishop Trust Co., Ltd., has acquired all of the capital stock of the Henry Waterhouse Trust Co., Ltd.

"2. In settlement of their indebtedness to the Henry Waterhouse Trust Co., Ltd., R. W. Shingle and wife have paid into that Company $435,000.00; A. N. Campbell has paid into it $100,000.00; and R. W. Shingle and A. N. Campbell are to convey to the Company or to its order their respective 18% and 10% undivided interests in certain land, fish ponds and fishery at the near Mokauea, Kalihi-kai, Honolulu, the same to be sold and the proceeds thereof, plus such additional sum (to be contributed by Bishop Trust Co., Ltd.) as shall be necessary to make a total of $100,000.00, to be paid to the Henry Waterhouse Trust Co., Ltd.

"3. The following corporations and individuals

have contributed or are to contribute the following sums to the Henry Waterhouse Trust Co., Ltd.: The Bishop Co., Ltd., $100,000.00; American Factors, Ltd., Alexander & Baldwin, Ltd., Castle & Cooke, Ltd., W. R. Castle and Beatrice Castle Newcomb each $50,000.00; and the Bank of Hawaii, Ltd., and the Hawaiian Trust Co., Ltd., each $25,000.00. For the amounts of these contributions notes of the Henry Waterhouse Trust Co., Ltd., of even date herewith, bearing simple interest at the rate of four per cent (4%) per annum, have been or will be given to the respective contributors, payable, however, only as provided in paragraph 8.

"4. The Bishop Trust Co., Ltd. will ultimately contribute such amount, if any, over the above sums aggregating $1,035,000.00, as may be required to liquidate the liabilities (other than the sums or notes mentioned in paragraph 3) of the Henry Waterhouse Trust Co., Ltd.

"5. The Bishop Trust Co., Ltd., will take over, own and operate at its own expense and for its own benefit, in its own name or in the name of the Henry Waterhouse Trust Co., Ltd., the business (with such of the furniture, equipment and supplies as shall be required therefor) other than the assets subject to the liabilities (referred to in paragraph 6) of the Henry Waterhouse Trust Co., Ltd. Any of the business so taken over by the Bishop Trust Co., Ltd., may by it be discontinued, sold or merged with its other business.

"6. The assets and liabilities of the Henry Waterhouse Trust Co., Ltd., will gradually be liquidated by applying the assets or their proceeds and the income therefrom to (a) the expenses involved in such liquidation (such as salaries, taxes, rent, insurance, legal, auditing, bank examiner, postage, cables, books, stationery, etc.); (b) $1,000.00 per month to the Bishop Trust Co., Ltd., for overhead or supervision; (c) interest payable; (d) indebtedness; and (e) other liabilities, if any. The assets shall be deemed to include cash on hand, bank deposits, notes and accounts receivable, stocks and bonds, stock exchange seat, and furniture, equipment and supplies (except as otherwise provided in paragraph 5) owned by the Henry Waterhouse Trust Company, Ltd., at the close of business on February 14, 1931, and the sums since paid or to be paid in as set forth in paragraphs 2, 3 and 4; the liabilities shall be deemed to include all liabilities of the Company as of that date, and liabilities subsequently incurred in connection with the liquidation; the expenses of operation shall be deemed to include, besides other items, the cost of investigation by accountants preliminary to the reorganization, the cost of an audit of the Company's affairs and of the set-up of the accounting system at the outset by accountants, a proper pro rata of salaries of officers and employees of the Bishop Trust Co., Ltd., transferred temporarily for the reorganization, rehabili-

tation and readjustment of the affairs of the Henry Waterhouse Trust Co., Ltd., at the outset and a proper pro rate of the salaries of officers and employees of the Henry Waterhouse Trust Co., Ltd., so long as their services are rendered in part in connection with the liquidation and in part in connection with the business taken over by the Bishop Trust Co., Ltd. It is proposed, for convenience, efficiency and economy, to transfer the various branches of the business to the Bishop Trust Building as soon as the circumstances warrant.

"7. In final settlement, the excess, if any, of the assets as defined in paragraph 6 or their proceeds and the income therefrom over the payments specified in paragraph 6 is to be applied, so far as it will go, in the following order of priority; First, to reimbursing the Bishop Trust Co., Ltd., for such amount, if any, without interest as may be contributed by it under paragraph 4 above; secondly, to paying pro rata, principal and interest, the notes mentioned in paragraph 3, and thirdly, the balance, if any, of such excess to be paid to the Bishop Trust Co., Ltd.

"8. The Henry Waterhouse Trust Co., Ltd., may from time to time borrow money (from the Bishop Trust Co., Ltd., and/or others) to meet its requirements in connection with the liquidation and repay the same with interest. The notes (principal and interest) mentioned in paragraph 3 shall be payable only if and to the extent that there shall be an excess of assets available therefor in final settlement after

the payments specified in paragraph 6 and the reimbursement of the Bishop Trust Co., Ltd., provided for in subdivision First of paragraph 7. The books of the Henry Waterhouse Trust Co., Ltd., shall be closed at the end of each calendar half year and a financial statement for such half year shall thereupon be furnished to each of the contributors named in paragraph 3. Such contributors shall have the right to inspect the books of the Company at all reasonable times."

"Supplementing our letter of the 21st instant in regard to the Henry Waterhouse Trust Co., Ltd.:

"1. There is a Finance Committee, consisting at present of M. B. Renshaw, J. L. Cockburn and E. W. Sutton, for frequent consultation on numerous matters, including many that naturally it would be impracticable to bring before the Advisory Committee referred to in the next paragraph.

"2. There will be an Advisory Committee for passing upon various matters of importance, particularly those tending to affect the amount of reimbursement, if any, ultimately to be made to the contributors mentioned in paragraph 3 of the letter above referred to—such matters as sales of stocks and bonds owned by the Company, compromises of claims by or against the Company, etc. This Committee will consist for the present of A. W. T. Bottomley, C. H. Cooke and A. L. Castle, with alternates as follows to act in their several respective places when they cannot act: H. A. Walker and

S. M. Lowrey, alternates to A. W. T. Bottomley; R. McCorriston and E. W. Carden, alternates to C. H. Cooke; F. C. Atherton and A. G. Budge, alternates to A. L. Castle."

Plaintiff received from the Waterhouse Company the following note, being the note referred to in the aforesaid letter dated February 21, 1931:

"($50,000.00) February 21, 1931

For value received, the Henry Waterhouse Trust Company, Limited, promises to pay to American Factors, Limited, Fifty Thousand Dollars ($50,000.00), with interest thereon from date at the rate of four per cent (4%) per annum, payment of principal and interest to be made only when, if and to the extent that there shall be funds available therefor as set forth in letter of this date from the payor to the payee.

HENRY WATERHOUSE
TRUST COMPANY,
LIMITED,

By /s/ W. F. FREAR,
Its President.

[Seal] By /s/ H. A. WHITE,
Its Treasurer."

Plaintiff was not a stockholder of the Waterhouse Company.

XXV.

That as of February 14, 1931, the $400,000.00 par value of capital stock of the Waterhouse Company was transferred to the Bishop Trust Company,

Limited, without any cash payment therefor, and the cash balances, properties, stocks and bonds, accounts, books and records of the Waterhouse Company came under the management and control of the Bishop Trust Company, Limited, as sole stockholder. New officers and directors were elected, a finance committee comprised of officers and directors, and an advisory committee comprised of representatives of the $400,000.00 noteholders, were appointed, and work was immediately commenced on the liquidation of the Waterhouse Company.

XXVI.

That an audit report dated March 31, 1931, of Tennent & Company, certified public accountants of Honolulu, T. H., disclosed the book value of assets of the Waterhouse Company, as of February 14, 1931, to be in the amount of $4,820,090.92, and the liabilities, exclusive of capital and surplus, to be in the amount of $4,149,437.06. It was stated in the audit report that the principal purpose of the audit was to establish as accurately as possible the total assets and liabilities as of February 14, 1931, the date control of the company passed to the Bishop Trust Company, and the audit report contained the following statement:

"The Contingent Reserve (for losses) of $680,-803.15 and the Special Contingent Reserve of $400,-000.00 referred to above, are considered adequate to cover probably losses in the realization of the assets and liquidation of liabilities."

The audit report also contained a statement expressing that the Special Contingent Reserve for Losses will remain intact until actual losses written off have fully exhausted that reserve and that additional losses as determined will then be applied pro rata against the Special Contingent Reserve contributions, to wit, the $400,000.00, representing the amounts paid in by the special noteholders.

In further explanation of Exhibit "A" referred to in paragraph V of stipulation I, particularly with respect to the item of estimated losses amounting to $1,080,803.15 shown thereon, the auditor who prepared the audit report containing Exhibit "A" hereinbefore described testified as follows:

"A. Exhibit "A", as I see it here, looks to me like it is an exact copy of what was Exhibit "A" in my report, as Government counsel said, so that the figures are identically the same. Now, then, that million and eighty thousand dollars, as it is shown there, is somewhat of a balance figure to make up the million eight hundred fourteen thousand dollars which is the difference of it, or the million and eighty is the difference between the million and eight hundred fourteen thousand and the $733,000 representing the Shingle and Campbell account. Now, then, the $1,814,000, according to my work papers, is made up first of the $1,548,000 about which I just testified, plus approximately $260,000 more that was added in there to make these figures balance out for two reasons: One being that between the January 31st scheduled preparation and

the February 14, 1931, Shingle and Campbell had paid in the $635,000 for one thing; also in making up the balance sheet of February 14, we had to take into account that there was an operating—that the company was operating and had gone on from January 1st to February 14th, and during that period the books reflected a loss of $10,149. Now, then, going back to the million and eighty thousand dollars, that is the figure which when the $400,000 paid in by the note holders—after that would be paid in and added to the $680,000 that shows as the net worth on the balance sheet, would make up the million eighty thousand dollars.

* * *

"Q. Mr. Greaney, you mentioned a figure of $260,000 being added to the estimated losses. Will you explain what that 260,000 odd represented?

"A. The $260,000 represented a cushion in effect and had the effect of being a cushion to take care of any losses over and above the amount that was put in the loss column on the schedule that was prepared, covering the individual receivables that were on the books.

"Q. And that was done for what purpose?

"A. That was done because by the time we got around to preparing the final report and putting the figures together, the Bishop Trust Company had agreed to take over the operation of the Waterhouse Trust Company and had changed its position somewhat from a position it had taken somewhat shortly prior to that time, that they would pay something

for the stock. And as it finally turned out they refused to pay anything for the stock so that the reserve for contingencies was made to balance up so that it would appear proper to pay nothing for the stock."

XXVII.

That the balance sheets of the Henry Waterhouse Trust Company as at February 14, 1931, after the aforesaid reorganization; and at December 31, 1931, and at December 31, 1932, were as follows:

Henry Waterhouse Trust Company Balance Sheets

Assets:	As at Feb. 14, 1931	As at Dec. 31, 1931	As at Dec. 31, 1932
	After Reorganization		
Cash	$1,044,547.87	$ 29,700.69	$ 14,639.50
Investments	605,181.47	.....	.....
Receivables	77,184.34	.....	15,214.69
Trust and agency accounts (Shingle & Campbell)	.....	.....	.....
Other trust & agency accts.	1,439,567.36	383,460.67	299,565.32
Loans	1,978,492.73	2,247,844.14	1,624,740.12
Other Assets	75,117.15	17,434.16	17,326.66
Stocks and bonds	.....	251,220.65	267,122.42
Stocks in subsidiaries	.....	303,704.16	303,704.16
Advances to subsidiaries	.....	324,382.60	314,787.92
Real estate for sale	.....	169,700.00	233,273.02
Expense in suspense	.....	.....	17,500.00
Profit and loss—Special	400,000.00	400,000.00	400,000.00
	$5,620,090.92	$4,127,447.07	$3,507,873.81

Liabilities:			
Overdrafts balances due Brokers, etc.	$ 457,545.90	$ 79,578.59	$ 46,648.10
Notes payable	223,100.00	376,557.98	674,190.88
Trust & Agency accounts	2,978,515.16	1,834,540.86	1,068,907.28
Loans pledged to clients	490,276.00	198,000.00	132,128.00
Merchandise accounts	.....	1,252.11	.....
Notes payable—affiliated Co.	.....	550,000.00	602,500.00
Income in suspense	.....	.....	2,417.13
P. & L. Acct.—operating deficit 2/14/31	(10,149.29)	(10,149.29)	(10,149.29)
P. & L. Acct.—operating deficit subsequent to 2/14/31	.....	(58,526.56)	(80,062.56)
Surplus & surplus reserves	.....	.....	.....
Reserve for losses	680,803.15	356,193.38	271,294.27
Contingent reserve—underwriters	400,000.00	400,000.00	400,000.00
Capital stock	400,000.00	400,000.00	400,000.00
	$5,620,090.92	$4,127,447.07	$3,507,873.81

At December 31, 1931, Henry Waterhouse Trust Company had sustained on liquidation actual losses amounting to $324,913.77, and at December 31, 1932, it had sustained on liquidation cumulative actual losses totalling $410,345.80, so that at the end of 1932 there was still a balance of $190,457.35 remaining in the Reserve for Losses, against which future losses must be paid before there would be any impairment for the repayment of the $400,000.00 contributions to the special noteholders.

XXVIII.

The note given by the Henry Waterhouse Trust Company to American Factors, Limited, in acknowledgment of the contribution of $50,000 made by that company in 1931 to the Henry Waterhouse Trust Company was contingent as to payment, being subject to such conditions as to render it non-negotiable at the time it was made and at all times thereafter, and without negotiable value from the time it was made. The considerations in payment for the contribution flowed to the payee at the time it was made —the protection of the commercial community, sympathy toward the Henry Waterhouse Trust Company clients who could ill afford to lose, and other commendable desires and motives of helpfulness and security, but there was no attempt to show and there is no evidence of record which would support a finding of fact that American Factors, Limited, would have suffered any loss had it not attempted to keep the Henry Waterhouse Trust Company a going concern.

XXIX.

Plaintiffs' books of account were kept on the accrual basis of accounting, and, during the calendar year 1924-1932, inclusive, they were so kept, and its Federal Income Tax returns for those years were made on that basis of accounting. In the calendar year 1932, Plaintiff charged off on its books of account the face amount of the aforesaid $50,000.00 Waterhouse Trust Company note which was given to the plaintiff in the year 1931, pursuant to the

actual method of charging off bad debts which the plaintiff used in that taxable year and all prior taxable years for income tax purposes.

XXX.

During the calendar year 1932 plaintiff paid the total sum of $4,063.33 to the following individuals in the amounts stated opposite their names, to wit:

Payee	Amount Paid
Mrs. R. C. Walker	$1,200.00
Minor children of John Frank, deceased	300.00
Minor children of W. Zablan, deceased	240.00
Mrs. Wm. Searby	1,800.00
Mrs. Luddecke	523.33
Total	$2,063.33

The above payments were to widows and minor children of former employees of plaintiff. The above payments were duly authorized and represented a percentage of salaries or other compensation paid to deceased employees who were related to the payees by marriage or otherwise and followed a practice of the plaintiff which had been in effect since 1920 in some instances and which practice these deceased employees and their dependents had a reasonable expectation to believe would be followed in the event of their death.

In its federal income tax return for the taxable yar 1932 plaintiff deducted the above amounts as ordinary and necessary expenses in computing its taxable net income. The Commissioner of Internal Revenue in his second deficiency letter disallowed the same.

XXXI.

That the payment to Mrs. R. C. Walker was in accordance with action taken by the Board of Directors of American Factors at a meeting held on May 18, 1920, at which it was decided to pay Mrs. Walker her deceased husband's salary in full up to June 30, 1920, with a bonus of 25% on the salary for the six months from January 1 to June 30, 1920, and beginning July 1, 1920, and until further action by the Board, she was to be paid a monthly allowance of $100.00.

XXXII.

That the payment to the minor children of John Frank, Sr., deceased, was authorized at a meeting of the Board of Directors of American Factors, Limited, held on November 27, 1922, at which meeting it was decided that the pension of $75.00 a month which had been paid to John Frank while living be continued in favor of his children and the amount of pension was authorized to be increased up to $100.00 a month to continue until further action by the Board.

XXXIII.

That the payment to Mrs. Searby was authorized at a meeting of the Board of Directors of American Factors held on November 29, 1929, at which a pension of $250.00 a month beginning January 1, 1930, and continuing until further action by the Board was authorized.

XXXIV.

That the payment made for the benefit of the minor children of W. Zablan was paid to the Social Service Bureau for disbursement of the funds from time to time for the benefit of the Zablan minors after an investigation by the Social Service Bureau and pursuant to written instructions given by the manager of the merchandise department and the treasurer of American Factors, Limited, under date of September 17, 1928.

XXXV.

That the payment made to Mrs. Luddecke was authorized by the manager of the merchandise department and treasurer of American Factors, Limited, on November 26, 1930, after an investigation of Mrs. Luddecke's financial circumstances had been made.

XXXVI.

That on April 5, 1938, plaintiff filed with the Commissioner of Internal Revenue through the Collector of Internal Revenue a claim for refund of $80,254.41, which included income tax for the calendar year 1932 in the principal amount of $62,-438.82, and interest thereon in the amount of $17,-815.49, which amount of tax and interest was paid by plaintiff to Collector Fred H. Kanne on December 30, 1937. Said claim was rejected in its entirety by the Commissioner on December 2, 1938.

XXXVII.

That on December 22, 1938, plaintiff filed with the Commissioner of Internal Revenue through the Collector of Internal Revenue a second claim for refund for the additional amount of $16,880.49 income tax for the calendar year 1932, paid by plaintiff to Collector Fred H. Kanne on October 26, 1938, which claim was rejected by the Commissioner of Internal Revenue on April 22, 1940.

XXXVIII.

No amount of the income tax and interest sought to be recovered in this action has been paid or refunded to plaintiff.

2.

Conclusions of Law

Upon the foregoing facts, testimony and evidence adduced in this case, the Court concludes as a matter of law as follows:

I.

Plaintiff is entitled to a deduction of $171,795.26 of the Hackfeld litigation expenses as ordinary and necessary expenses paid or incurred during the taxable year 1932 in carrying on its business, within the terms of Section 23(a) of the Revenue Act of 1932, and accordingly is entitled to a deduction of that amount in computing its taxable net income for the calendar year 1932. The Commissioner of Internal Revenue erred in not treating the said sum of $171,795.26 as ordinary and necessary expenses incurred

during the taxable year 1932 in carrying on plaintiff's business, and erred in disallowing plaintiff a deduction for that amount of the Hackfeld litigation expenses in computing its taxable net income for the calendar year 1932.

II.

The sum of $396,812.50 of the Hackfeld litigation expenses which plaintiff refunded or repaid in the year 1932 to those persons and corporations who were co-defendants with plaintiff in said litigation were not ordinary and necessary expenses paid or incurred during the taxable year 1932 by plaintiff in carrying on its business within the terms of Section 23(a) of the Revenue Act of 1932, and plaintiff is not entitled to a deduction therefor of that amount in computing its taxable net income for the calendar year 1932. The Commissioner of Internal Revenue did not err in disallowing the deduction of $396,812.50 to plaintiff in computing its taxable net income for the calendar year 1932.

III.

The plaintiff's stockholders or co-defendants to whom plaintiff repaid in the year 1932 at the conclusion of the Hackfeld litigation the sum of $396,812.50 of the litigation expenses previously contributed and collected by them could have been abandoned or modified the agreement which had previously been entered into between the said co-defendants, other than plaintiff, to share on a per-

share basis the expenses of said litigation at any time, but so long as their plan and agreement was adhered to, it was binding on all of them and there was no legal obligation or liability on the part of plaintiff to reimburse or refund to its stockholders who were co-defendants with it in the Hackfeld litigation the sum of $396,812.50 which plaintiff repaid to them in 1932.

IV.

As between the stockholders of plaintiff who were co-defendants in the Hackfeld litigation, within ultra vires limitations, they could authorize the repayment to themselves by way of distribution of the company's funds of the sum of $396,812.50, so long as none was injured, and none of the other stockholders complained. No other stockholder was injured and no other stockholder complained.

V.

The payment of $50,000 made to the Henry Waterhouse Trust Company in 1931 by plaintiff was just a contribution. The note given by the Henry Waterhouse Trust Company in 1931 to plaintiff in acknowledgment of that contribution was contingent as to payment, being subject to such conditions as to render it non-negotiable and without any negotiable value at the time it was made and at all times thereafter, and therefore it could not be dealt with as a debt, and the Commissioner of Internal Revenue did not err in disallowing plaintiff

a deduction therefor as a bad debt in computing plaintiff's taxable net income for the calendar year 1932.

VI.

No part of this contribution of $50,000.00 was deductible as a bad debt, ascertained to be worthless and charged off within the taxable year 1932 within the terms of Section 23(j) of the Revenue Act of 1932 or as a loss sustained during that taxable year not compensated for by insurance or otherwise, within the terms of Section 23(f) of the Revenue Act of 1932, and accordingly no part of said contribution was properly allowable as a deduction in computing plaintiff's taxable net income for the calendar year 1932.

VII.

The aforesaid payments to dependents of deceased employees was a usual, necessary and proper practice, which it is well recognized would tend to the gratification, good will and loyalty of employees in general and thus be a benefit to business operations, particularly in a business under many department heads and of varied ramifications, as was the business of American Factors. The payments made for the benefit of dependents of deceased employees were ordinary and necessary expenses paid or incurred in carrying on plaintiff's business during the taxable year 1932 within the terms of Sec. 23(a) of the Revenue Act of 1932 and did constitute a proper deduction in computing its taxable net in-

come for that taxable year. The Commissioner of Internal Revenue erred in disallowing these payments as a deduction in computing the plaintiff's taxable net income for the calendar year 1932.

Entry of judgment in conformity with the foregoing findings of fact and conclusions of law is hereby directed.

Dated at Honolulu, T. H., this 15th day of June, 1949.

/s/ GILBERT E. METZGER,
Judge, U. S. District Court.

[Endorsed]: Filed June 15, 1949.

In the United States District Court for the Territory of Hawaii

Civil No. 419

AMERICAN FACTORS, LIMITED, a Hawaiian corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix under the Will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii,

Defendant.

JUDGMENT

Be it remembered that on November 12, 1947, there came on for trial the above-entitled and num-

bered action wherein this case having been submitted to the Court without a jury upon the pleadings, oral and documentary evidence, and a stipulation of facts, and argument of counsel, and the Court being sufficiently advised, and having made and filed its opinion and findings of fact and conclusions of law herein, now therefore, in pursuance thereto,

The Court having found that the plaintiffs paid income taxes and interest assessed thereon for the taxable year 1932, as follows:

Dates of Payment	Tax	Interest
December 30, 1937	$62,438.82	$17,815.59
October 26, 1938	12,657.68	4,222.81
Total payments	75,096.50	22,038.40
Adjusted liability	50,915.94	14,527.78
Overpayments	$24,180.56	$ 7,510.62

It is hereby ordered, adjudged, and decreed that the plaintiff have and recovered from Agnes M. Kanne, Executrix under the will and of the estate of Fred H. Kanne, deceased, the defendant, formerly Collector of Internal Revenue for the District of Hawaii, the sum of $31,691.18 representing an overpayment of federal income tax and interest for the taxable year 1932, together with interest thereon as provided by law from the dates of payments, as follows:

On the overpayment of tax in the amount of $12,-657.68, and the overpayment of interest thereon of $4,222.81 from October 26, 1938; and on the overpayment of tax in the amount of $11,522.88, and

interest thereon of $3,287.81 from December 30, 1937, together with the costs of this suit in the amount of $50.71.

To the foregoing judgment, the defendant in open court excepted.

Entered this 15th day of June, 1949.

/s/ DELBERT E. METZGER,
U. S. District Judge.

Approved as to Form:
RAY J. O'BRIEN,
United States Attorney.

By /s/ KENNETH [Illegible],
Assistant U. S. Attorney.

[Endorsed]: Filed and entered June 15, 1949.

[Title of District Court and Cause.]

CERTIFICATE OF PROBABLE CAUSE

This cause having come on for hearing before the Court without a jury, the case having been submitted upon the pleadings, oral and documentary evidence, and a stipulation of facts, and arguments as to the law, and the defendant having appeared herein by the United States Attorney for the District of Hawaii, and the Court having found partially in favor of the plaintiff, and judgment having been entered in favor of the plaintiff and against the defendant in the principal sum of $31,691.18 representing an overpayment of federal in-

come tax and interest for the taxable year 1932, together with interest thereon as provided by law from the dates of payment, and costs of suit in the amount of $50.71,

Now therefore, pursuant to Section 989 of the Revised Statutes of the United States, the Court hereby certifies there was probable and reasonable cause for the act of the defendant, Fred H. Kanne, Collector of Internal Revenue for the District of Hawaii, since deceased, and that he acted under the directions of the Secretary of the Treasury or other proper official of the Government in demanding and collecting from plaintiff the internal revenue tax, for the refund of which the judgment in this case is rendered.

/s/ ROBERT E. METZGER,
U. S. District Judge.

[Endorsed]: Filed June 15, 1949.

[Title of District Court and Cause.]

NOTICE OF APPEAL TO CIRCUIT COURT OF APPEALS UNDER RULE 73(b)

Notice is hereby given that Agnes M. Kanne, Executrix under the Will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii, defendant above named, does hereby appeal to the United States Circuit Court of Appeals for the Ninth Cir-

cuit from the final Judgment entered in this action on the 15th day of June, 1949, ordering that the plaintiff have and recover from Agnes M. Kanne, Executrix under the Will and of the Estate of Fred H. Kanne, deceased, the defendant, formerly Collector of Internal Revenue of the United States for the District of Hawaii, the sum of $31,691.18, together with costs in the amount of $50.71.

Dated: Honolulu, T. H., this 4th day of August, 1949.

/s/ RAY J. O'BRIEN,

Attorney for Agnes M. Kanne, Executrix Under the Will and of the Estate of Fred H. Kanne.

[Endorsed]: Filed August 4, 1949.

[Title of District Court and Cause.]

NOTICE OF APPEAL TO UNITED STATES COURT OF APPEALS UNDER RULE 73(b)

Notice is hereby given that American Factors, Limited, an Hawaiian Corporation, plaintiff above named, does hereby appeal to the United States Court of Appeals for the Ninth Circuit from so much of the Final Judgment entered in this action on the 15th day of June, 1949, as orders that the plaintiff have and recover from Agnes M. Kanne, Executrix under the Will and of the Estate of Fred H. Kanne, Deceased, the defendant, formerly Collector of Internal Revenue of the United States

for the District of Hawaii, only the sum of $31,-691.18, together with interest thereon as provided by law and costs of suit in the amount of $50.71, and denies to said plaintiff the recovery of the full amount of $97,134.90 with interest and costs as prayed for in the complaint filed herein.

Dated: Honolulu, T.H., this 15th day of August, 1949.

SMITH, WILD, BEEBE & CADES.

By URBAN E. WILD and

/s/ MILTON CADES,

Attorneys for American Factors, Limited, Plaintiff.

[Endorsed]: Filed August 15, 1949.

[Title of District Court and Cause.]

BOND FOR COSTS ON APPEAL

Know All Men By These Presents:

That American Factors, Limited, an Hawaiian Corporation, as principal, and Hartford Accident and Indemnity Company, a corporation organized under the laws of the State of Connecticut, as surety, are held and firmly bound unto Agnes M. Kanne, Executrix under the Will and of the Estate of Fred H. Kanne, Deceased, formerly Collector of Internal Revenue of the United States for the District of Hawaii, defendant, in the sum of Two Hundred Fifty Dollars ($250.00) for the payment of

which well and truly to be made, said American Factors, Limited, as principal, and Hartford Accident and Indemnity Company, as surety, do bind themselves, their respective successors and assigns, jointly and severally, and firmly by these presents.

The Condition of This Obligation Is Such That:

Whereas the above bounden principal, American Factors, Limited, has filed its notice of appeal to the United States Court of Appeals for the Ninth Circuit from the decree entered in the above-entitled cause;

Now, Therefore, if the said principal shall prosecute said appeal with effect and answer all costs if it fails to sustain said appeal, then this obligation shall be void, otherwise it shall remain in full force and effect.

Dated: Honolulu, T. H., this 15th day of August, 1949.

AMERICAN FACTORS,
LIMITED.

By /s/ H. A. WALKER,
Its President.

[Seal] By /s/ W. T. VORFELD,
Its Treasurer,
Principal.

HARTFORD ACCIDENT AND
INDEMNITY COMPANY.

[Seal] By /s/ JAMES A. MULKERN, JR.,
Attorney in Fact,
Surety.

Territory of Hawaii,
City and County of Honolulu—ss.

On this 15th day of August, A.D. 1949, before me personally appeared James A. Mulkern, Jr., and to me personally known, who, being by me duly sworn did say that he is Attorney in Fact of the Hartford Accident & Indemnity Company, a corporation, of Hartford, Connecticut, duly appointed under Power of Attorney dated the 19th day of September, A.D. 1947, which power of attorney is now in full force and effect, and that the seal affixed to said instrument is the corporate seal of the said corporation and that said instrument was signed and sealed on behalf of said corporation under the authority of the Board of Directors and the said James A. Mulkern, Jr., and acknowledged the said instrument to be the free act and deed of the corporation.

[Seal] /s/ J. EDITH JORDAN,
Notary Public, First Judicial Circuit, Territory of Hawaii.
My commission expires June 30, 1953.

Territory of Hawaii,
City and County of Honolulu—ss.

On this 15th day of August, 1949, before me appeared H. A. Walker and W. T. Vorfeld, to me personally known, who, being by me duly sworn, did say that they are the President and Treasurer, respectively, of American Factors, Limited, a Ha-

waiian corporation, and that the seal affixed to the foregoing instrument is the corporate seal of said Corporation, and that the instrument was signed and sealed in behalf of said corporation by authority of its Board of Directors, and the said H. A. Walker and W. T. Vorfeld acknowledged said instrument to be the free act and deed of said corporation.

[Seal] /s/ J. EDITH JORDAN,
Notary Public, First Judicial Circuit, Territory of Hawaii.

My Commission expires June 30, 1953.

[Endorsed]: Filed August 15, 1949.

[Title of District Court and Cause.]

STIPULATION EXTENDING TIME TO FILE TRANSCRIPTS OF RECORD ON APPEALS

It Is Stipulated and Agreed by and between the attorneys for the respective parties herein that the time of defendant-appellant to file a Transcript of Record on Appeal be and the same hereby is extended to and including the 2nd day of November, 1949, and that the time of plaintiff-appellant to file a Transcript of Record on Appeal be and the same hereby is extended to and including the 13th day of November, 1949.

Dated: Honolulu, T. H., September 19, 1949.

/s/ RAY J. O'BRIEN,
U. S. Attorney for the
District of Hawaii,
Attorney for Defendant.

SMITH, WILD, BEEBE & CADES.
By /s/ MILTON CADES,
Attorneys for Plaintiff.

So ordered September 20, 1949.

/s/ D. E. METZGER,
U. S. District Judge.

[Endorsed]: Filed September 20, 1949.

[Title of District Court and Cause.]

STIPULATION FURTHER EXTENDING TIME FOR FILING RECORD ON APPEAL AND DOCKETING APPEAL

Whereas it will not be possible for the court reporter to finish transcribing testimony of certain witnesses by November 2, 1949, the date when the Record on Appeal was to be docketed in the United States Court of Appeals for the Ninth Circuit.

It Is Hereby stipulated and agreed by and between the attorneys for the respective parties herein that both the Plaintiff and the Defendant may have, subject to the approval of the United States Court of Appeals for the Ninth Circuit, to and including the 18th day of November, 1949, within which to file the Record of Appeal and docket the Appeal.

Dated: Honolulu, T. H., this 31st day of October, 1949.

/s/ RAY J. O'BRIEN,
United States Attorney,
District of Hawaii.
Attorney for Defendant.

SMITH, WILD, BEEBE & CADES.

By /s/ MILTON CADES,
Attorneys for Plaintiff.

[Endorsed]: Filed October 31, 1949.

[Title of District Court and Cause.]

DOCKET ENTRIES

1940

Jan. 6—Filing Complaint and Exhibits "A and B"
Issuing Summons
Making 3 certified copies for service
Filing Marshal's returns to Summons. (Executed)

Mar. 5—Filing Stipulation
Mar. 16—Filing Stipulation
Apr. 8—Filing Stipulation
May 14—Filing Answer
June 27—Filing Order

1947

Mar. 6—Filing Motion to Substitute Executrix as Defendant with Consent of Executrix
Mar. 7—Filing Memorandum
Nov. 5—Entering order setting case for trial to Nov. 12, 1947, at 10 a.m.
Nov. 12—Entering proceedings at trial & continuance to Nov. 13, 1947, at 10 a.m. for further trial
Nov. 13—Entering proceedings at further trial & continuance to Nov. 14, 1947, at 9:30 for further trial
Nov. 14—Entering proceedings at further trial & continuance to Nov. 15, 1947, at 10 a.m. for further trial

1947

Nov. 15—Entering proceedings at argument and decision by Court

Filing Transcript of Decision from Bench

Nov. 17—Filing Motion to Amend Answer to Conform to the Evidence and Points and Authorities

1948

Jan 2—Filing Statement of Disapproval of the Form of Defendant's Draft of Findings of Fact and Conclusions of Law

Filing Proposed Additions and Amendments to Defendant's Draft of Findings of Fact and Conclusions of Law

Feb. 11—Filing Defendant's Reply to Plaintiff's Disapproval of the Form of Defendant's Draft of the Findings of Facts & Conclusions of Law

Filing Additions and Amendments to the Draft of Findings of Fact and Conclusions of Law Heretofore Submitted by Defendant

Feb. 16—Filing Objections to Amendments to Defendant's Draft of Conclusions of Law

Mar. 18—Filing Decision

1949

June 15—Filing Findings of Fact and Conclusions of Law

Filing Judgment

1949

Filing Certificate of Probable Cause
(Judgment—Plaintiff recover the sum of $31,691.18 and int. from deft.—Metzger —Judge)

Aug. 4—Filing Notice of Appeal to Circuit Court of Appeals under Rule 73(b)

Copy of Notice of Appeal mailed to counsel for plaintiff

Aug. 15—Filing Notice of Appeal to United States Court of Appeals under Rule 73(b)

Copy of Notice of Appeal mailed to counsel for defendant

Filing Bond for Costs on Appeal

Sept. 20—Filing Stipulation Extending Time to File Transcripts of Record on Appeals

Oct. 31—Filing Stipulation as to Designation of Record on Appeal

Filing Stipulation Further Extending Time for Filing Record on Appeal and Docketing Appeal

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[Title of District Court and Cause.]

CERTIFICATE OF CLERK

United States of America,
District of Hawaii—ss.

I, Wm. F. Thompson, Jr., Clerk of the United States District Court for the District of Hawaii, do hereby certify that the foregoing partial record on appeal in the above-entitled cause, consists of the

following listed original pleadings of record in said cause:

Complaint, Exhibit "A" and "B"

Answer

Motion to Substitute Executrix as Defendant with Consent of Executrix

Motion to Amend Answer to Conform to the Evidence and Points and Authorities

Decision

Findings of Fact and Conclusions of Law

Judgment

Certificate of Probable Cause

Notice of Appeal to Circuit Court of Appeals under Rule 73(b)

Notice of Appeal to United States Court of Appeals under Rule 73(b)

Bond for Costs on Appeal

Stipulation Extending Time to File Transcripts of Record on Appeals

Stipulation as to Designation of Record on Appeal

Stipulation Further Extending Time for Filing Record on Appeal and Docketing Appeal

I further certify that included in said partial record on appeal is a copy of all docket entries.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court, this 1st day of November, 1949.

[Seal] /s/ WM. F. THOMPSON, JR.,
Clerk, United States District Court, District of Hawaii.

In the United States District Court for the Territory of Hawaii
Civil No. 419

AMERICAN FACTORS, LIMITED, a Hawaiian Corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix Under the Will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii,

Defendant.

Civil No. 474

ALEXANDER & BALDWIN, LIMITED,

Plaintiff,

vs.

AGNES M. KANNE, Executrix Under the Will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii,

Defendant.

TRANSCRIPT OF PROCEEDINGS

In the above-entitled matter, held in the U. S. District Court, Honolulu, T. H., on November 12, 13, 14 & 15, 1947, [1*]

Before: Hon. Delbert E. Metzger,
Judge.

* Page numbering appearing at top of page of original Reporter's Transcript.

Appearances:

URBAN E. WILD, ESQ.,
Of the law firm of Smith, Wild, Beebe & Cades, appearing for American Factors, Limited, Plaintiff;

MILTON CADES, ESQ.,
Of the law firm of Smith, Wild, Beebe & Cades, appearing for American Factors, Limited, Plaintiff;

DUDLEY C. PRATT, ESQ.,
Of the law firm of Vitousek, Pratt & Winn, appearing for Alexander & Baldwin, Limited, Plaintiff;

VERNON BORTZ, ESQ.,
Of the law firm of Vitousek, Pratt & Winn, appearing for Alexander & Baldwin, Limited, Plaintiff;

RAY J. O'BRIEN, ESQ.,
United States Attorney, appearing for the Defendant;

EDWARD A. TOWSE, ESQ.,
Assistant United States Attorney, appearing for the Defendant;

LELAND T. ATHERTON, ESQ.,
Special Assistant to the Attorney General, appearing for the Defendant. [2]

The Clerk: Civil No. 419, American Factors,

Limited, Plaintiff, vs. Fred H. Kanne, Collector of Internal Revenue.

Mr. Wild: Ready for the Plaintiff, your Honor.

Mr. Atherton: Ready for the Defendant, your Honor.

Mr. Wild: At this time, may it please the Court, counsel in the Alexander and Baldwin case have asked that the Court hear them make a motion to the effect that the record made and taken in the case now before your Honor concerning the Henry Waterhouse note issue and the loss issue, and so forth, be considered as a part of the record in their case, I think.

Mr. Pratt: Yes, your Honor. The Alexander and Baldwin case, your Honor, is Civil 474, and I believe that counsel for the Government is willing to stipulate at this time that the record on the issue with respect to the Henry Waterhouse Trust Company matter, that is, the record in this American Factors case be considered as part of the record in our case. And my understanding is that the other issues in Civil 419 are to be heard first and that they will be followed by the evidence with respect to the Henry Waterhouse Trust Company transactions. Our case and the American Factors' case in most respects on that issue will be the same.

The Court: What other issues, if any, are involved?

Mr. Pratt: We have one very minor issue which is mentioned [3] in the stipulation which will be submitted to the Court. Most of the facts concern-

ing our case have also been stipulated to, and the stipulation, one, which we will submit, will be identical with the American Factors' stipulation one, except for the facts which are different by reason of its being Alexander and Baldwin, Limited and not American Factors; and the fact that we had one other minor deduction that year with respect to another contribution. Those are covered in a written stipulation. However, on the main issue of Henry Waterhouse Trust Company the facts will be the same, with one other exception, that is, that on our books there is a journal entry of a write-off of $25,000 in the year 1931, and then the entire $50,000 which is claimed for tax purposes in 1932, although there was no claim for a tax deduction in '31. There is that distinction between the facts in ours and American Factors' case.

I would like to have counsel for the Government stipulate that the record in this 419 case may be considered on that issue, may be considered in Civil 474. We didn't want to actually consolidate the cases, your Honor, because of difficulties, if any appeal might be taken.

Mr. Atherton: The Government so stipulates, your Honor, with the understanding that it would be limited to the supplementary testimony taken here, that is, supplementary to the stipulated facts.

Mr. Pratt: Yes.

Mr. Wild: Your Honor, I rise now to ask that the Court, counsel approve that stipulation and add to the stipulation that the evidence taken in the

Alexander and Baldwin case—I haven't the number—concerning the Henry Waterhouse Trust Company issue other than the stipulation which may be filed there will be considered as a part of the record for all purposes in Civil No. 419.

The Court: Well, you say the evidence taken in the Alexander and Baldwin case relative to the Waterhouse Trust transaction. Well, now, the A. and B. is going to put in evidence?

Mr. Wild: Yes, your Honor.

The Court: In that?

Mr. Pratt: Our understanding in that, your Honor, was that following the hearing in this matter we would have a brief hearing in connection with 474, Alexander and Baldwin case, in which we would put in some evidence.

The Court: That is satisfactory.

Mr. Atherton: No objection, your Honor.

The Court: All right.

Mr. Wild: At this time, may it please the Court, as there is no jury and the issues of fact and law are to be heard by your Honor, I would ask that we follow this procedure: that we introduce in evidence the various instruments, [5] including the stipulations, decisions of the Court; then, with that background, we make an opening statement to the Court in which we outline our positions of law on the facts and the facts; then that we proceed with the facts involved in the stipulations; and then that we adduce such oral testimony as is proper after that. Counsel for the De-

fendant reserves his right, of course, to object on the admission of any of the items in evidence. I might say in that regard, your Honor, that counsel for the Defendant has been very generous with his time, and we have gone over all of the issues. He has seen, I believe, all of our exhibits, so that he is thoroughly familiar with what we would put in. Isn't that a fair statement?

Mr. Atherton: That is a fair statement, your Honor.

The Court: Well, I understand, then, that what you would propose to offer in evidence at this time are documents that you and opposing counsel have agreed were proper evidence.

Mr. Wild: Well, your Honor, no. Both sides reserve the right to object to paragraphs in the stipulations on any grounds that they deem advisable. I had understood before that counsel for the Government, that his objections were written in two paragraphs of the stipulation, and I just understood this morning that he intends to make other objections. But we would ask the Court to receive those in evidence and then rule on the objections later in the case. As I [6] understood from counsel, what he wants to do is to save any right to complain of error.

Mr. Atherton: May I interpose right here? I think, your Honor, that if we are going to deal with stipulation No. 2 first,—I assume you are going to discuss——

The Court: Let's see your stipulations.

Mr. Wild: Well, I was going to offer in evidence, I thought that I would offer in evidence the stipulations as they are numbered. They are stipulations No. 1 and No. 2. We needn't take them up in that order in the discussion. Perhaps it would be best if I would just go ahead. I think it would save time, and counsel could make his objections.

Mr. Atherton: Well, let me speak to the Court a moment. Your Honor, what I have in mind is, I think that the stipulation should be read. It is not very long. And as each paragraph is read, in order that you may be fully informed of what the facts stated are—all we are stipulating in the written stipulation is that the statements of fact made therein are true, reserving to each of us the right to object to the admissibility in evidence of the facts, all those stated to be true. Now, in the preparation of these stipulations it occurred to me that I should write into them certain objections. But since then it occurred to me that I should make objection to other paragraphs to which I failed to note in the written stipulations a specific objection. [7] Therefore, I want an opportunity when this stipulation is offered to object seriatim to each paragraph or accept each paragraph, raise no objection thereto, so the record may be perfectly clear.

The Court: Well, as long as the Court can keep track of the situation as it develops and not to become confused by a great mass of documentary

evidence put into the lap of the Court to digest, it seems to me all right to proceed with the two stipulations. They cover all this documentary evidence, do they? They mention it?

Mr. Wild: They don't to the exclusion of all else, your Honor, because in the Hackfeld litigation I have and will offer in evidence the record in that case made up of complaint and answer, decision, findings of fact, and so forth, you see, your Honor. And we have referred to portions of those in the stipulation.

The Court: Well, wouldn't it be better first to read your stipulations to the Court before we take up the matter of offering the documents in evidence?

Mr. Wild: Very well, your Honor. I have no objection to that.

The Court: Have you got an extra copy for the Court?

Mr. Wild: Yes, your Honor. I have the original for the Court. This is the original.

The Court: The stipulation has been filed with the clerk? [8]

Mr. Wild: No, your Honor. It has just been signed.

The Court: This is stipulation No. 2?

Mr. Wild: That is right, your Honor.

The Court: Would that come first, or is there a number one?

Mr. Wild: I have a stipulation No. 1 which deals with the Henry Waterhouse Trust and note issue.

I would prefer to wait the reading of that stipulation until that stage of the case was reached. Now, your Honor, the reason this stipulation was not filed with the clerk of the Court was because both counsel reserved the right to object to anything that was in the stipulation. But we had gone over them and counsel informed me that there were two objections he wanted to make, one in stipulation No. 2 and one in stipulation No. 1. So it is a total surprise to me this morning when he says he has other paragraphs he now wants to object to.

Shall we proceed with the reading of stipulation 2?

The Court: Yes.

Mr. Wild: Then, your Honor, might I say this: I want to make my opening statement after the stipulation is read, and after these other things are adduced in evidence.

Mr. Atherton: Excuse me now before you start. Shall the Government interpose its objections as each paragraph is read?

The Court: I think that would be the proper thing to do. [9]

Mr. Atherton: And note its consent?

Mr. Wild: Stipulation No. 2: "It is hereby stipulated by and between the parties hereto through their respective attorneys that the following statements of fact shall be considered as true, and that either party may offer in evidence, oral testimony or any additional evidence, documentary or other-

wise not inconsistent with the facts herein stipulated.

"When the United States entered the First World War, H. Hackfeld & Company, Limited, (hereinafter referred to as 'Hackfeld Co.') was an Hawaiian corporation, which was then conducting and had conducted for many years prior thereto a sugar plantation agency, general merchandise store and other businesses and was a large factor in the Hawaiian sugar industry and in other businesses in the Territory of Hawaii; that Hackfeld Co., had been and was at that time controlled by German interests; that on or about January 28, 1918 and during March, 1918, the Alien Property Custodian of the United States seized the stock of Hackfeld Co., owned by German Nationals and gained control either directly or indirectly of approximately sixty-eight and one-half (68½) percent of its capital stock."

Mr. Atherton: The Government has no objection to that paragraph, your Honor.

Mr. Wild: Paragraph 2: "Prior to January 28, 1918—" [10] we would ask your Honor—well, maybe perhaps at the end I am going to ask that the whole stipulation be received in evidence, subject to objections to be ruled on afterwards. You are not waiving anything there.

Mr. Atherton: Well, I just want it understood that now to state my objection—do I have to repeat it again or shall I wait until the end?

The Court: Well, perhaps it would be more scientific to wait until it is offered in evidence.

Mr. Atherton: Very well.

Mr. Wild: Two: "Prior to January 28, 1918, the business of Hackfeld Co., had been seriously disrupted as a consequence of restrictions placed upon it by the Allied Governments as the result of its German affiliations and those of its stockholders. A plan for the reorganization of said company was formulated in the office of the Alien Property Custodian of the United States of America, (hereinafter referred to as 'Alien Property Custodian'), which plan as thereafter perfected is fully set forth in a resolution adopted by the stockholders of that company on July 19, 1918, a copy of which is attached to the Answer of the defendants, Respondents (exclusive of the Alien Property Custodian) filed in Isenberg et al., Plaintiffs, Complainants v. George Sherman, et al., Defendants, Respondents, being No. 149913 Dept. No. 2 in the Superior Court of the State of California, in and for the [11] City and County of San Francisco, (hereinafter referred to as the 'California Case') as Exhibit A thereof."

The Court: No objection to that?

Mr. Atherton: No objection to that, your Honor.

Mr. Wild: Three: "In the decision filed on March 16, 1926 in the California Case referred to in Paragraph II supra, the Court in its Findings of Fact found in part as follows:

'VIII.

'The organization of American Factors, Limited, as a new corporation to take over the business and assets of H. Hackfeld & Co., Ltd., as a going concern and whose stock, or trust certificates therefor, was to be sold to American citizens, was an integral part of said plan.

'X.

'It was the opinion of the Alien Property Custodian at all times after the seizure of said stock that the sale of the business and assets of H. Hackfeld & Co., Ltd., as a going concern and the preservation and continuance of its business rather than its disintegration were for the best interests of the stockholders of said corporation. He was also of the opinion and so determined that the best interests of the public and the proper administration of the Trading with the Enemy Act required such preservation [12] and continuance of said business.

'XI.

'It was the opinion and judgment of the Alien Property Custodian that it was necessary for the continued welfare and prosperity of said business and to public confidence in said business and to the successful consummation of his plan for its reorganization, that persons in Honolulu who were conversant with business of a similar nature should assume its direction. Such opinion and judgment were reasonable and proper. The defendants named in paragraph XX of the complaint, other than the

defendants H. L. Scott, Richard H. Trent and Trent Trust Company, Ltd., organized a joint subscription, substantially all the joint subscribers to which were known to and reported to the Alien Property Custodian, for the purchase of at least one-half of the stock of American Factors, Ltd., to the end that they might control and direct said American Factors, Ltd., in continuing the business of H. Hackfeld & Co., Ltd., and retain the agencies theretofore held by it, and so that the public invited to subscribe to the stock of American Factors, Ltd., might do so in reliance upon the management of said business by representatives of corporations conversant with and theretofore highly successful [13] in similar business, and to the end that said public having so subscribed, should be protected in its investment.

'About 637 persons subscribed to and became stockholders of American Factors, Ltd.

'XXXIV

'Long prior to the meeting of July 19th, 1918, the Alien Property Custodian was advised that the defendants, Castle & Cooke, Limited, Alexander & Baldwin, Limited, Matson Navigation Company, C. Brewer & Company, Limited, Welch & Company, J. B. Atherton Estate, Limited, Henry P. Baldwin, Limited, Charles M. Cooke, Limited, G. N. Wilcox, S. W. Wilcox, A. S. Wilcox, Wallace M. Alexander, George Sherman, J. F. Lowrey, F. C. Atherton, R. A. Cooke, and others, proposed to purchase more than one-half of the stock proposed to be issued by

the new corporation which was to succeed to the business of H. Hackfeld & Co., Ltd. The Alien Property Custodian was well acquainted with the identity and business connections of said defendants whose names were furnished to him.

'It was the aim and purpose of the Alien Property Custodian, stated and believed by him to be for the best interests of said corporation and its stockholders, and it was in fact to the best interests of said corporation [14] and its stockholders, that a large portion of the trust certificates mentioned in said stockholders' resolution of July 19, 1918, should be purchased by persons familiar with the sugar agency business in the Hawaiian Islands, and by persons who could properly and efficiently manage said business, and in whom the subscribing public would have confidence. To that end it was the desire of the Alien Property Custodian and his plan, that a large portion of said trust certificates should be purchased by those persons and corporations who were then engaged in the plantation agency business in Hawaii.

'It was the purpose of the Alien Property Custodian to induce the defendant firms who were then engaged in the sugar agency business, to subscribe to said trust certificates in order to insure the success and continuance of the business of H. Hackfeld & Co., Ltd., or the successor corporation to be formed. It was believed by the Alien Property Custodian that in that manner he could best secure the prosperity of the corporation which was to take

over the business and assets of H. Hackfeld & Co., Ltd., under said plan adopted by the stockholders of H. Hackfeld & Co., Ltd., on July 19th, 1918. It was the opinion of the Alien Property Custodian that the public of Hawaii would more readily [15] subscribe to the trust certificates to be issued under said plan if the control and management of said successor corporation were in the hands of the defendant firms then engaged in the sugar agency business in the Territory of Hawaii. The opinion and belief of the Alien Property Custodian in these respects were reasonable.

'The Alien Property Custodian therefore desired the purchase by said defendants and their associates in this finding first above named and referred to, of a large part of the trust certificates representing the stock of American Factors, Ltd., and acquiesced in the allotment to said defendant firms and their associates upon their subscriptions of one half of said trust certificates.' "

Mr. Atherton: Now, your Honor, the Government objects to the admissibility in evidence of all the paragraphs recited in paragraph three of the stipulation for the reason that the defendant, the United States, was not a party to the proceedings before the state court in the Hackfeld litigation, and therefore the recital of the findings of fact by that court, California court in that case, is not only hearsay but it is incompetent, irrelevant and immaterial to any issue involved in this suit. And if it is

admitted over the Government's objection in evidence, we wish the record to show that the evidence shall be limited strictly to this particular [16] action.

Mr. Wild: May it please the Court,——

Mr. Atherton: Now, in support of the Government's position as to the objection, I have had occasion to examine Jones' Commentary on Evidence, Second Edition, Volume 4 at page 3368, Section 1816, and footnote 16, reciting a number of cases which support the Government's position with respect to this objection. Also I assume that later counsel for the Plaintiff may offer in evidence a certificated copy of the court's findings of fact, and in anticipation of that the same objection obtains with respect to that document as to these recitals of the particular paragraphs taken therefrom.

Mr. Wild: May it please the Court, the objection is wholly erroneous. The thing that the United States Government has done is to deny a deduction for the defense of this very suit. They are bound by what happened in that suit just as much as we are. The United States Government doesn't have to be a party to every transaction that involves Federal taxes. If it did, the taxpayer would have no defense at all. The taxpayer would have to retry every issue with the Government. I have never found any authority, I have never heard one cited before in a Federal tax case to the effect that when the Government denies the deduction of an expense

of defending certain litigation that the litigation itself is [17] hearsay to the Government.

Mr. Atherton: Your Honor, the pleadings in that case are properly admissible from the Government's viewpoint. They show the gist of the action and what the parties were suing for. It is of no importance to this Court, we believe, as to what the findings of fact were in that case. All that this Court may be possibly concerned with from the Government's viewpoint is that any evidence with respect to the Hackfeld litigation may be received only for the purpose of showing that what the issue was determined in that case, not otherwise.

Mr. Wild: Well, counsel's statement, then, is an admission that this all goes in because the Court's decision——

Mr. Atherton: No.

Mr. Wild: ——findings of fact and law that were based on that, that the decision was based on, are the ultimate determination when affirmed on appeal as to the nature of the case, your Honor. In this particular case the record will show that there were 32 volumes of transcript of testimony; that the trial lasted nine months, the most titanic legal struggle, I think, on the west coast in at least my time. During the trial of such length it is obvious that the various positions taken in the complaint and answer may have been modified many times in the trial. The Government bound itself by whatever the Court decided in that case as [18] to the nature of the complaint, as to the nature of the defense,

and as to the finding of evidence on the trial. The Government denies a deduction, and the facts as shown and decided by the Court are material in enabling this Court to determine whether or not the Government's denial was proper. I submit, your Honor, that counsel's own statement shows very clearly that the Government's position is unfounded.

Mr. Atherton: Your Honor, I'd like to respectfully call your attention to paragraph 14 of the stipulation which you have before you. You will find it on page 11.

Mr. Wild: Wait a minute. We are not there yet.

Mr. Atherton: But this supports my objection. There you will find a statement of the memorandum filed by the trial judge in that case, which in the opinion of Government counsel, taken together with the pleadings in that case, should suffice to show the issue determined in that case without regard to a detailed recital of the findings of fact found by the court.

Mr. Wild: May it please the Court, it is obvious that counsel is much concerned by the effect of the detailed findings of the court upon the Government's case. He finds that it is consummate to victory to have those in. Otherwise he wouldn't object. Now, may it please the Court, under California practice, as your Honor well knows, it is required that after a short summary decision findings of fact and [19] conclusions of law be found by the Government. There is no judgment entered in the case until after that step is taken. Prior to that time

that step is taken the court may change its opinion. And it is submitted that any part of the proceedings in this cause is at issue here because the Government has made it so. Counsel will await the ruling of the Court, your Honor.

The Court: Well, it is understood that the Court rules on these objections as they are made now, after the reading of the stipulation or at the time when the stipulation is offered in evidence. I assume that the stipulation will be offered in evidence.

Mr. Wild: Yes, your Honor.

The Court: So we might just as well assume that the stipulation is now offered in evidence.

Mr. Wild: Yes, your Honor.

The Court: My view is that with the material set out in paragraph 14, that is, the opinion which was the final decision of the court in the case, that all that is necessary for any purpose here, that that is all that is necessary for any purpose here that I can see.

Mr. Wild: Your Honor, may I call your Honor's attention to one error in that ruling? This decision by the court set out in paragraph 14 is not the final decision at all. The final decision is exactly what we have been quoting from; [20] the final decision and findings of fact of the court, which instead of being filed on January 6, 1926, was filed on March 16, 1926. Your Honor is right in the conclusion that the final finding of the trial court is the issue that is before the Court. And the final finding of the trial court is the decision and judgment that was

issued in this Court on March 16, 1926. I have a certified copy of that, your Honor, and if your Honor lets in the preliminary finding referred to in paragraph 14, your Honor would have excluded from this case the final decision of the lower court. And it is submitted that on your Honor's own statement that it is the final decision of the Circuit Court that it is inadmissible with the findings of fact on that statement. It seems to me that the paragraph should be received. We would feel loath, your Honor, to introduce in evidence in this cause the 32 volumes of transcript of testimony. Unless and until we get in the record not the pleadings of the parties but what the findings were, and what the facts were as determined, how can this Court pass upon the meat of this litigation? And that is the precise thing that counsel for the Government fear. They know that if your Honor passes on the meat of this litigation that their contentions are groundless.

The Court: Now, you have there the final decision in the California court? [21]

Mr. Wild: Yes, your Honor, and I am going to offer it in evidence.

The Court: Suppose you offer it now—the foundation is laid—and let the objection then be to the offer of that as evidence.

Mr. Wild: I would now offer in evidence, may it please the Court, the decision, findings of fact and conclusions of law of the judge, the trial judge, in that certain cause in the Superior Court of the

State of California in and for the City and County of San Francisco, in the case of J. C. Isenberg, et al., versus George Sherman, et al., No. 149,913 in that cause. I have a certified copy of it here, your Honor, which shows on the face that it was filed on March 16, 1926, and it shows that that is the final decision of the court.

The Court: You are acquainted with this?

Mr. Atherton: Yes, I have read that. And as far as I have been able to ascertain from reading it, your Honor, it doesn't modify in any respect the memorandum opinion of the trial judge which was filed on January 6, 1926. It merely amplifies it. And I still repeat the Government's objection to the admission in evidence of this certified copy of the court's so-called final decision, findings of fact and conclusions of law. We are not trying in this case, your Honor, the Hackfeld suit. At the time the parties co-defendant in [22] that suit incurred liabilities for these expenses, litigation expenses that they are seeking as a deduction in the present tax suit, they were not aware of the outcome of that litigation. The Government's defense is predicated on the ground that as the litigation progressed the liability for the expenses was incurred and paid by all parties litigant, and that they were incurred and paid then without respect to the ultimate outcome of the litigation; and their deductibility for Federal income tax purposes was determined at the time that the liability therefor was incurred and paid, and not until the litigation

was concluded. Where you have paid a liability, there can be no question as to its subsequent accrual; the payment discharges the liability forthwith.

The Court: May I ask now, just what is the materiality of this decision which was rendered here some four years after the tax deduction was claimed as a basis for this suit?

Mr. Wild: Well, your Honor, I hadn't intended at this time to open this statement—perhaps it would be as well for me now to make a statement of our position. Counsel's statement this morning comes as a complete surprise to me. I was led to believe up to no later than yesterday that he had no objection to this whole record going in. If so, I would have had authorities to prepare. I told him I was going to put them in. He stated frankly to me that neither he nor the Department had ever seen this decision, that it was wholly [23] new to him. I loaned it to him over a week-end so that he might read it. But may I digress a moment in my theory of the cause? Your Honor, the findings in this decision became final in 1932 when the Supreme Court of the State of California refused to recall the remittor in the opinion of the court, which I will come to subsequently. At the outset and before the litigation was filed, your Honor, it was rumored that the persons referred to in this paragraph who under the guidance of the Alien Property Custodian had brought American Factors into being were to be sued for fraud and damages

claimed against them. As we would see further in other paragraphs of the stipulation, knowing that they were going to be sued for fraud and as the only actors that could make American Factors liable, they would be the ones, individuals and corporations. American Factors, if it were liable under that litigation, would only be liable because of their acts. They very properly entered into an agreement among themselves to bear the cost of the Hackfeld litigation until there was a final determination of the cause. They bore, paid up a certain amount of the cost of the litigation.

When there was a decision finally determined by the court that everything they had done had been for the benefit of American Factors and that there was no fraud, at that moment, your Honor, there arose in the law a complete obligation upon the part of American Factors to reimburse all the litigation expenses. Every act that had been done was for the benefit of American Factors.

Under the law of restitution, and under the opinions as cited by the courts—to which I will hereafter in my opening statement refer, your Honor—there is no question that under these facts that the Government now finds they can't stipulate to without losing their case. There is no question that under that law there arose the obligation to reimburse these people for their expense. And I have the decisions of eminent courts on that, and I also have the restatement of the law concerning restitution.

Now, may it please the Court, the Government knows in this cause that it is material to the issue to decide the deductibility, that the exact nature of the holding and the finding be before this Court. They don't think this is mere surplusage. They know from the very averment of the objection to this evidence going in—and it is the final decision of the lower court which only becomes final and became final in 1932. And it was entered three months after this memorandum. The Government knows that with that in the record there is a complete showing that in the year 1932 when that case became final there was an obligation on American Factors to reimburse all the litigants.

So that if I might say so—just adverting to a part of my opening statement and the law upon which it is founded— [25] that this decision being the very decision and the point at issue, is not only material to the issue but when it becomes final in 1932 it lays the foundation for the Plaintiff's case, and lays the destruction, I might say, of the Government's position. And the Government is just realizing it.

Now, may it please the Court, I don't want to go into my opening statement at this time. I don't want to state the law on some of the issues here as yet. But I do want to call your Honor's attention to some of the authorities. And it seems to me, your Honor, it is obvious that on any authority these findings could be material, and they must be re-

ceived as laying a foundation for the determination one way or another.

For instance, it is a well-established rule that one person, or persons who have an interest in a trust fund, or having an interest in a corporate history, or at their own expense take proper proceedings to save the funds from destruction, or to restore the funds, are entitled to reimbursement either out of the funds or by proportional contribution from those who accept the benefits of their efforts.

Under those paragraphs of the findings, your Honor, the Court would have to hold that it was found by the trial court and became final in '32 that these people have defended American Factors. They are found to be without fraud. They protected American Factors from a judgment claim of ten million dollars. And it shows their part in it, and that their part came under the direction of the Alien Property Custodian; and at that time—which theory is affirmed in Trustees of International Improvement Fund versus Reno, 26 Law Edition 1157 by the Supreme Court of the United States—at that time there was an obligation to reimburse the other defendants in the case that arose for American Factors.

Now, may it please the Court, counsel is attempting to bring out Ab initio a lot of positions which probably we should have stated to start with. He talks about the accrual basis, American Factors is on the accrual basis. The uniform rule of law is

that when a corporation is on the accrual basis for income tax purposes that it cannot accrue items which are on litigation until the final act is taken concluding the litigation.

The latest decisions in the Supreme Court of the United States, the latest decision, Dixie Pine Products Company against Commissioner of Internal Revenue, 1944, the headnote states,

"A taxpayer who acts on the accrual basis may and should deduct from gross income a liability which really accrues in the taxable year. And in order truly to reflect the income of a given year, all the events must occur in that year which fixed the amount and the facts of the taxpayer's liability for items of indebtedness deducted, [27] though not paid. A taxpayer acting on an accrual basis cannot deduct a liability which is still contingent and is being contested by him."

Then a note as to this case:

"The rule prohibiting the deduction for Federal income tax purposes of contingent liabilities is frequently applied where the liability in question depends upon the outcome of litigation."

That is exactly what this liability depended upon. It depended upon the outcome of the litigation, and the nature of that outcome.

I have no hesitency in telling your Honor that had the decision of this trial court been that respondent other than Factors had been fraudulent, as was the Plaintiff's claim, and had these other findings been reversed, that American Factors then

would not have been authorized to accrue any part of the legal expense of H. Hackfeld and Company. You see, it is our contention that under the accrual law and under these very recent cases sustaining it, that once the very nature, the essence of the claim is shown—and that essence is shown in the findings of the trial court but not binding until they become final—under that very essence are we entitled to the deduction. And the Government fears it because otherwise they wouldn't make any objection to it.

The Court: Well, wouldn't the costs and fees have been [28] the same, no matter which way the case had gone?

Mr. Wild: Oh, no, your Honor. The amount would have been the same, your Honor, but let me just picture it this way: the amount would have been identical but the question as to who was to bear it was different. If your Honor please, all these people actually carried out a plan under the guidance of the Alien Property Custodian, and if there had been any fraud found in that plan, American Factors wouldn't have paid a cent of the litigation expenses. It was a corporation. The whole of that litigation expense would have been paid by the other defendants because American Factors could not be liable as between itself and those who were fraudulent to pay any part of the expense of those who were fraudulent. Let me put it this way, your Honor: I hire an agent; the agent does a fraudulent act, or another does a fraudulent act for me; I am not liable to that agent to pay the cost of ex-

pense and litigation expense that his fraud causes me. As between myself and that agent, I make him pay the whole bill.

Well, frankly, here the agreement that was entered into at the outset was that American Factors acted as this banker, put up the money for litigation expenses that were approved by a group that I will come to later; billed these people, billed these people for the whole cost of the litigation until three hundred ninety-six thousand had been paid up; [29] and then after the decision in the lower court—and that became final in the upper court—the balance of litigation expenses was paid, which was some eighty-three thousand in that year, and a small amount had been paid in addition over the year. Now, right at that time, your Honor, when these people were held to have been, finally held to have been free from blame, and as every act done was an act for the benefit of Factors under the law of restitution, American Factors was obligated to reimburse them. And not only that—there is a legal opinion that was given on it. The stockholders voted the approval of it. All this I will show later.

So that, your Honor, it is submitted that it is the gist of this cause, as set forth in the findings and the decision of the trial court, which is the final decision of the trial court, but it didn't become final until in 1932. It is the gist of that that is necessary so that this Court can pass upon the issues of law that are involved in it.

The Court: Well, wasn't that an afterthought, though, coming to the Factors and its managing officers?

Mr. Wild: No, your Honor.

The Court: To pay this cost of litigation in full?

Mr. Wild: No, your Honor, no.

The Court: To reimburse those who had agreed to and had carried the burden of it because they had much to lose when charged with fraud? When it turned out the other way, I am [30] asking, wasn't it something of a motion of gratitude, benevolence, to reimburse them what they had been out?

Mr. Wild: No, your Honor, not at all. It is clearly legal liability on the Factors' part. The point I am making there is this, your Honor: under the law of restitution, as it is understood, there was a legal or equitable obligation; and in the restatement of the law of restitution, it doesn't make any difference whether it is legal or equitable; obligations that arise when out of justice of the situation, when those who have borne the brunt of conferring a benefit—and the defense of a suit is a benefit—have been shown to have gained something for the other person that was involved. Now, Factors was involved in a secondary way. While it is true there was an allegation that Factors was a party to the conspiracy, it, as a corporation, apart from its officers, as between themselves, couldn't be a part of any conspiracy at all. It could have the obligation of a conspirator to the outside public, your Honor, but as between itself and the fraudulent

actors it would have a right against them for whatever damage the fraudulent acts had caused them. Now, that is very clear-cut. And it is submitted, your Honor, that right here in 1932 when the decision became final American Factors became legally or equitably liable to reimburse.

Now let me read to your Honor from authority, the restatement of the law on restitution: [31]

"Section 1. Unjust enrichment. A person who has been unjustly enriched at the expense of another is required to make restitution to the other.

"Comment: A person is enriched if he has received a benefit (see Comment b). A person is unjustly enriched if the retention of the benefit would be unjust (see Comment c). A person obtains restitution when he is restored to the position he formerly occupied either by the return of something which he formerly had or by the receipt of its equivalent in money.

"b. What constitutes a benefit. He confers a benefit not only where he adds to the property of another, but also where he saves the other from expense or loss."

Just as here, by coming in, putting up their money in the defense of the suit, they have saved American Factors from that expense, and they conferred a benefit when they got the assets of H. Hackfeld and Company, under the circumstances as are shown in this decision of the trial court, for the benefit of American Factors.

"c. Unjust retention of benefit. The mere fact

that a person benefits another is not of itself sufficient to require the other to make restitution therefor. Thus, one who improves his own land ordinarily benefits his neighbors . . ."

He is entitled, however, to the restitution where it is unjust [32] for the other to retain the benefit.

Now, officious conferring of a benefit: "A person who officiously confers a benefit upon another is not entitled to restitution therefor."

Now, did these people officiously confer the benefits? Why, your Honor, the benefit here is getting the business and assets of American Factors, Limited, away from H. Hackfeld and Company.

The plaintiffs in the suit claim there was a ten million dollar damage. The method of conferring that benefit, who conferred it, how it was conferred, the fact that they were not officious in conferring the benefit—all those things are shown in this finding of fact by the trial court which became final, however, in 1932 when all the appeals had been terminated.

How could your Honor, for instance, determine whether these people when they took part in the formation of American Factors were officious, whether what they did came under this rule of law, or whether they didn't, unless we have the holding of the court on it? And we are bound by that holding of the court. If that holding of the court had said that these people were officious, we'd be bound by that holding as against the United States Government, or they are bound by it as against us.

Now, going on with this: "Policy ordinarily requires [33] that a person who has conferred a benefit either by way of giving another services or by adding to the value of his land or by paying his debt or even by transferring property to him should not be permitted to require the other to pay therefor, unless the one conferring the benefit had a valid reason for so doing."

Now, the discharge of a duty I owed to another, in topic 3 of the restatement, is another basis for the receipt of the evidence. Suffice it to say, your Honor, in summary, the Federal Government is wholly bound in its tax contentions by whatever the determinations were in that case. This Court is entitled to have before it the determining issues of law raised in good faith by the plaintiff, those findings of fact, and it is a necessary part of the record of this cause and there couldn't be a trial of this case, your Honor, without that in it. I don't see how there could be.

Mr. Atherton: Your Honor, without waiving in any respect the Government's objection to the admissibility in evidence of these findings, and so forth, I want to call the Court's attention to the fact that if you should happen to examine those findings you will find that the court did not include as a matter of law—you will find that there was no trustee relationship existing between the incorporators and those who became the stockholders of American Factors and American Factors; that there was no agency relationship [34] established between

those parties; and that, as a matter of fact, the Hackfeld litigation grew out of acts of the alleged conspirators before the American Factors even was organized as a corporation. It was an alleged conspiracy to incorporate and organize the American Factors to take over and acquire the assets of the Hackfeld Company. So I think that that suffices on that aspect of it.

Now, with respect to the accrual of the liabilities, counsel for the Plaintiff cited the case of Security Flour Mills Company versus Commissioner of Internal Revenue, 321 U. S. 281, in support of his position that despite the fact that the legal expenses and litigation expenses were paid currently as they were incurred by the parties litigant, the co-defendants, according to a pre-trial agreement between themselves, he takes the position that under the rational of that case nevertheless at the conclusion of the litigation, to wit, 1932, all of those expenses became a proper accrual to American Factors. I wish to call the Court's attention to the decision of the U. S. Court of Claims in the case of Chestnut Securities Company versus United States, 62 Federal Supplement, page 574 at page 576, a decision which was handed down on October 1, 1945, after the decision in the Security Flour Mills Company case, and there the U. S. Court of Claims undertakes to discuss and to analyze the opinion in the Security Flour Mills Company case and points out aptly there, [35] as I pointed out here, that in that case the taxpayer had denied liability but paid it, and

the court said, "We think it thereby 'accrued' the taxes and interest, if accrual is requisite at all, in the case of the debtor, when actual payment has occurred."

Elsewhere in that opinion you will find where the court says that there can be no accrual when there is a discharge of liability by payment.

Now, I take it that the evidence in this case will show that these expenses, as they were incurred by these co-defendants, were actually paid; that American Factors billed them for their pro rata share and actually discharged the indebtedness as it went along. And then, while it is true undoubtedly, as the evidence will show, that American Factors carried the entire amount as a deferred item on its books. There is nothing that will be shown in the record, so far as I understand—and I don't expect that the oral testimony will prove otherwise—that there was any dispute as to liability or that there was any belief or belief conveyed to the stockholders, the co-defendants, by the American Factors that American Factors felt that at any time it might be under obligation to refund this $396,000 which it had collected from its co-defendants to them at the conclusion of the litigation. So that there was no dispute as to liability there. And the mere fact that American Factors carried the entire amount as a deferred item on its books doesn't in itself establish that there was any issue between the co-defendants and American Factors as to the ultimate liability for those litigation expenses.

And as far as this so-called unjust enrichment benefit, the parties who benefitted here were the individuals and person who were named as the alleged conspirators rather than American Factors, because American Factors obviously couldn't be a party to a conspiracy when it was non-existent.

Mr. Wild: Your Honor, counsel has stated there one reason why that very material——

The Court: I think I will allow this decision to be put in as an exhibit.

Mr. Wild: Your Honor, might I state this, in our stipulations we have annexed exhibits to them, and we have called them in one "A," starting with "A," "C," "B," "C" and "D." And in the other stipulation we started numbering them 1 and 2. Might this exhibit be numbered Plaintiff's 1 so that there wouldn't be any confusion when we talk about exhibit 1?

The Court: All right, I see the point.

Mr. Atherton: I want the record to show that the Government takes an exception, your Honor.

The Court: All right. "P-1."

(The document referred to was received in evidence as Plaintiff's Exhibit P-1.) [37]

The Court: I think the reporter has been working at rather high speed, and I think we will take a brief recess now.

Mr. Wild: Very well.

(A short recess was taken at 11:15 a.m.)

After Recess

Mr. Wild: May it please the Court, if we may proceed, I thought at this time, in view of the fact that your Honor has admitted this stipulation, P-1, the decision and findings of fact of the trial court, that I would like to offer in evidence a photostatic copy of the complaint in that cause, certified by the Clerk of the Federal Court, and ask that it be received as Exhibit P-2.

The Court: This is what, it is a photostat of what?

Mr. Wild: A photostatic copy of the complaint in the Hackfeld suit filed in California.

The Court: Any objection?

Mr. Atherton: No objection, your Honor.

The Court: That is Exhibit P-2.

(The document referred to was received in evidence as Plaintiff's Exhibit P-2.)

Mr. Wild: And at this time, your Honor, I would like to offer in evidence a photostatic copy, certified by the Clerk of the Federal Court, of the answer filed on behalf of the Defendant with exhibits annexed thereto. [38]

Mr. Atherton: No objection.

The Court: You said certified by the Clerk of the Federal Court?

Mr. Wild: No, California court, your Honor, not the Federal Court.

The Court: This is an answer to this?

Mr. Wild: That is the answer to the Hackfeld complaint with the exhibits annexed.

The Court: Received as Exhibit P-3.

(The document referred to was received in evidence as Plaintiff's Exhibit P-3.)

Mr. Wild: And then I have here an answer of the Alien Property Custodian of the United States, certified copy thereof, certified by the Clerk of the Superior Court of the State of California, in the Hackfeld litigation, and ask that that be received as P-4.

Mr. Atherton: No objection to that.

The Court: All right.

Mr. Wild: It just makes a picture, your Honor.

The Court: That is the Custodian?

The Clerk: Alien Property Custodian.

(The document referred to was received in evidence as Plaintiff's Exhibit P-4.)

Mr. Wild: Now shall we proceed with the stipulation?

The Court: Yes. [39]

Mr. Wild: We had completed the first three paragraphs.

The Court: Right.

Mr. Wild: There was an objection made on three, and your Honor suggested that we offer the decision, which we have done. I assume that your Honor makes the same ruling about that paragraph in the stipulation and as to the objection.

The Court: About the paragraph?

Mr. Wild: Yes.

The Court: Yes, if that same material is in the decision, I don't know any reason why this should be ruled out in the stipulation.

Mr. Atherton: I just thought it was redundant, your Honor.

Mr. Wild: It presents a short study of the case.

The Court: Yes. All right.

Mr. Wild: Shall we proceed with paragraph four, your Honor?

The Court: Yes.

Mr. Wild: "The subscription for trust certificates for shares of American Factors, Ltd., is attached to the Answer filed in the California case as Exhibits B and C thereof and shows that the participants subscribed to a total of twenty-seven thousand (27,000) shares of stock in blocks of stock, ranging from one hundred (100) to two [40] thousand five hundred (2,500) shares, conditioned upon the allotment of a minimum of twenty-five thousand (25,000) shares to the group; that the joint subscription agreement was accepted for a total of twenty-five thousand (25,000) shares and trust certificates were issued to and paid for by the said signers of the said joint subscription agreement for the total of said twenty-five thousand (25,000) shares; that trust certificates, representing the other twenty-five thousand (25,000) shares of the Plaintiff's capital stock were allotted to and paid for by approximately six hundred and fourteen (614) other persons and corporations."

Mr. Atherton: No objection.

Mr. Wild: "V. That trust certificates, representing fifty thousand (50,000) shares of the capital stock of Plaintiff, were issued and sold for the price of one hundred and fifty dollars ($150.00) per share and the total stated consideration of seven million, five hundred thousand dollars ($7,500,000.00) was duly paid in cash or United States Liberty Bonds at par to Hackfeld Co., and in exchange therefor Hackfeld Co., conveyed all of its assets and businesses as a going concern on August 20, 1918 to the Plaintiff and Plaintiff assumed all liabilities of Hackfeld Co. and of the business, and Plaintiff thereafter continued the business as a going concern."

Mr. Atherton: No objection. [41]

Mr. Wild: "VI. That included among the subscribers participating in the joint subscription agreement were persons who were incorporators of American Factors, Limited, and persons who subsequently became officers and directors of that corporation or of Hackfeld Co., or who otherwise participated in the business and affairs of Plaintiff."

Mr. Atherton: No objection.

Mr. Wild: "VII. That about June 1924, the then directors of American Factors, Limited were informed that former stockholders of Hackfeld Co., then dissolved, threatened to initiate litigation; that at that time it was not known what form the litigation would take nor who would be the Defendants; that the Board of Directors of American Factors,

Limited, after consideration, authorized its president to secure counsel for American Factors, Limited, to prepare for and to conduct the defense in the threatened litigation; that American Factors, Limited procured the services of attorneys to represent it in the threatened litigation."

Mr. Atherton: No objection.

Mr. Wild: "VIII. Prior to the filing of the suits in the threatened litigation above mentioned, twenty-one of the twenty-three persons and corporations who had joined in the joint subscription agreement for the shares of stock of American Factors, Limited, described in paragraph IV of this stipulation, entered into a written agreement under date of July 28, 1924, a true copy of which is annexed hereto as Exhibit 1 and made a part hereof, wherein they agreed to prorate on an original per share basis the expenses of the aforesaid threatened litigation if they were joined as defendants therein. Two of the individuals who had joined in the joint subscription agreement hereinbefore described did not participate in the agreement of July 28, 1924, to share the expenses of the threatened litigation because they had died. American Factors, Limited was not a party to the agreement of July 28, 1924."

Mr. Atherton: No objection.

Mr. Wild: Now, the Exhibit 1 is as follows, your Honor:

"The undersigned persons and corporations hereby agree each for himself and itself and not for the others of them with Allen W. T. Bottomley,

C. R. Hemenway, F. C. Atherton and R. A. Cooke, provided only that he or it is made a party defendant or one of the parties defendant to the suit or suits hereinafter mentioned but not otherwise, to contribute and pay on demand such a proportion of all of the costs and expenses of every description hereinafter mentioned as the number of shares represented by the trust certificates hereinafter mentioned originally subscribed for and issued to them bears to all of the shares represented by all of the said trust certificates subscribed for and issued to all of the subscribers hereto who are made parties defendant to the suit [43] or suits hereinafter mentioned or any of them.

"The costs and expenses hereinbefore mentioned are such as the said Allen W. T. Bottomley, C. R. Hemenway, F. C. Atherton and R. A. Cooke or any three of them acting in the name or on behalf of all of them have already paid or incurred or shall or may hereafter pay or incur in or about or in connection with the defense of any suit or suits which may be instituted against the undersigned or any of them upon or pursuant to the notice and demand made by J. F. Neylan as attorney for Mrs. Paul Isenberg and others, dated June 24th, 1924, or by any of the stockholders of H. Hackfeld & Company, Limited, an Hawaiian corporation which has been dissolved or is in process of dissolution by reason of or arising out of either the organization of the American Factors, Limited, or the sale and transfer of the assets of H. Hackfeld & Company, Limited,

to the said American Factors, Limited, or the appointment of trustees by H. Hackfeld & Company, Limited, of the whole of the shares of the capital stock of American Factors, Limited; or the sale and issue by the said trustees of trust certificates of shares of the said American Factors, Limited, to sundry persons, firms and corporations or any of the acts and deeds of the said trustees.

Dated, July 28th, 1924."

Then are the signatures of Alexander and Baldwin, Limited, 2300 shares, by John Waterhouse, vice-president; Henry P. [44] Baldwin, Limited, and the other signatures which I do not need to read, your Honor. That, I take it, is received as part of the paragraph.

"IX. That the suit of J. C. Isenberg, et al., Plaintiffs, Complainants, hereinafter called 'Hackfeld Plaintiffs' v. George Sherman . . . American Factors, Limited, et al., Defendants, Respondents, hereinafter called 'Hackfeld Defendants,' and which litigation, hereinafter called the 'Hackfeld litigation,' was commenced in August and September 1924; that identical complaints in the Hackfeld litigation were filed in the Circuit Court of the First Judicial Circuit, Territory of Hawaii, and in the Superior Court of the State of California in and for the City and County of San Francisco; that by stipulation between the parties the case filed in the California court was tried; that American Factors, Limited was one of the defendants named in the

Hackfeld litigation and the twenty-three corporations and persons, including the representatives of the estates of the two deceased persons who had signed the joint subscription agreement, were joined as Hackfeld Defendants."

Mr. Atherton: No objection.

Mr. Wild: "X. The Supreme Court of California, as reported in 212 Cal. 454, 461; 298 Pac. 1004 at page 1006, said of the aforesaid complaint:

'. . . The purport of the complaint is to require the [45] individual and corporate respondents to account to complainants for all matters and things concerning the transfer and sale of the assets of H. Hackfeld & Company, Limited, to American Factors, Limited, an Hawaiian corporation, organized for the express purpose of taking over the business and assets of said H. Hackfeld & Company, Limited. The gist of the complaint affirms the sale and alleges that the sale and transfer were the result of conspiracy, collusion, and fraudulent connivance on the part of certain of the respondents, whereby they secured the assets and profitable business of H. Hackfeld & Company, Limited, at a price far below its alleged intrinsic value, in fraud of and to the financial injury of complainants. The object of the suit is to require respondents to account to complainants for the transfer and sale of the assets of H. Hackfeld & Company, Limited, to American Factors, Limited, and to account for the difference between $7,500,000, the price at which the assets were sold, and the actual value of the

assets of the corporation at the date of transfer, which appellants claim to be $17,500,000. The Alien Property Custodian of the United States was made a respondent, but no relief or judgment is sought against him, it being alleged that his interest as trustee for certain of the stockholders "is identical with the [46] interest of the complainants herein," but not having joined as a complainant, he is joined as a respondent, "so that, as such trustee, he may properly receive the benefits of any judgment which may be entered herein." Certain other persons are made formal respondents for the same reasons.' "

Mr. Atherton: The Government makes the same objection as to the admissibility of that paragraph as it did with respect to the other on the finding of facts and conclusions of law of the Circuit Court of California.

The Court: Well, I don't quite see the purpose of that.

Mr. Wild: Well, the purpose of it, your Honor, is simply that it shows the determination of the court as to its construction of the complaint, what was claimed. And it seems to me that it is a part of the litigation which the Court should have before it when it is passing on the other matter.

The Court: Well, I don't see what is particularly prejudical to any interest here. The objection is overruled.

Mr. Wild: I might say, your Honor, that some of these paragraphs are the background so that you get a complete picture of a portion of the case. Paragraph XI——

Mr. Atherton: Your Honor, may I have the reporter read that? Did you overrule the Government's objection?

The Court: Yes. [47]

Mr. Atherton: I didn't quite hear.

The Court: You reserve an exception?

Mr. Atherton: I wish to note an exception.

Mr. Wild: "XI. That the complaint in the aforesaid action, in Paragraph XXXVI thereof, in substance, alleged that American Factors, Limited took and received all of the assets of Hackfeld Co., with full knowledge of all the facts and circumstances set forth in the complaint, and with full knowledge of and concerning the rights and equities of the stockholders of said Hackfeld Co., and did thereafter handle the said assets and conduct said business in trust for the protection by it of the rights and equities of said stockholders and the complainants, and said American Factors, Limited did so mismanage said business and did so improperly handle said assets as to cause great damage to said assets and business and great injury to the rights and equities of said stockholders and complainants, and that the American Factors, Limited was a party to the fraudulent scheme and the conspiracy therein alleged, and holds said business and said property in trust to protect the rights and equities of complainants, and that by its mismanagement of said business and said assets, it has caused further and additional loss to said business and to said stockholders of said Hackfeld Co., and to the complain-

ants in the sum of upwards of Two and One-Half Million Dollars in addition to all other damage and loss suffered by complainants."

Mr. Atherton: Your Honor, since the complaint is in, why, the Government feels that paragraph is redundant. It should be struck from the stipulation.

Mr. Wild: Well, it should be but it is a short way of expressing it.

The Court: I think that that is true. That occurred to me, that in the preceding paragraph perhaps is redundant. Well, it is before the Court. You object to it?

Mr. Atherton: Well, no, I won't object to it.

The Court: All right.

Mr. Wild: It is a shorthand picture for your Honor.

The Court: That was the purpose of having this stipulation?

Mr. Wild: Yes.

The Court: To read and consider it paragraph by paragraph.

Mr. Wild: Paragraph XII. "The prayers in the above referred to complaint, among others, included the following:"

Now, I don't want anything in here that is redundant, but both counsel asked to put in just for the picture for the Court the paragraphs that they thought were material, and I thought that by putting them in here we are saving some time for the Court.

The Court: Well, now, instead of reading those,

just [49] pass that and I can read those later and save some time.

Mr. Atherton: No objection.

Mr. Wild: None at all, your Honor? Paragraph XIII.

"That the attorneys employed by American Factors, Limited investigated the facts and matters pertaining to the Hackfeld litigation and prepared a joint answer on behalf of American Factors, Limited and the other Hackfeld Defendants, except the Alien Propert Custodian and the nominal Defendants and signed and filed the answer on behalf of such Hackfeld Defendants. A separate answer was filed on behalf of the Alien Property Custodian."

Mr. Atherton: No objection.

Mr. Wild: "XIV. The trial judge filed the following memorandum on January 6, 1926:

'I am of the opinion that (1) no actual fraud on the part of respondents was shown; (2) no constructive fraud existed; (3) the price paid was adequate; (4) the suit is not barred by the Hawaiian statute of limitations; (5) plaintiffs were not guilty of laches. Frank J. Murasky, Judge.'

The trial judge's memorandum quoted above is taken from the report of the Supreme Court of California in the case of Isenberg v. Sherman, 212 Cal. 454, 461; 298 Pac. 1004. On March 16, 1926 a decision comprising Findings of Fact and Conclusions of Law was filed, and on January 31, 1927, judgment [50] was entered for the defendants and against the complainants."

Mr. Atherton: No objection.

Mr. Wild: "XV. An appeal was perfected by the plaintiffs in the aforesaid equity suit (the California Case) to the Supreme Court of the State of California, where further hearings and arguments were had in the matter on appeal, and on April 30, 1931, the California Supreme Court rendered its opinion affirming the judgment of the trial court. The opinion of the Supreme Court of California is reported in 212 Cal. 454, 298 Pac. 1004. On May 28, 1931, the Supreme Court of California denied a petition for rehearing filed by the Hackfeld plaintiffs. The opinion of the Supreme Court of California denying this petition for rehearing is reported in 212 Cal. 507, 299 Pac. 528. Thereafter a motion to recall the remittitur issued to the County Clerk of San Francisco was filed by the complainants on August 26, 1931, and the Supreme Court of California in a decision handed down on January 29, 1932, denied complainants' motion to recall the remittitur. The decision of the Supreme Court of California giving a reason for the denial of the motion to recall the remittitur is reported in 214 Cal. 722, 7 P. 2d 1006. On April 25, 1932, the Supreme Court of the United States denied a petition filed by the Hackfeld plaintiffs for writ of certiorari to the Supreme Court of California, 286 U. S. 547."

Mr. Atherton: No objection. [51]

Mr. Wild: Your Honor, I take it that the Court

will take judicial knowledge of the opinions of the Appellate Court of the State and it won't be necessary to offer them as being considered in evidence for the purposes necessary, either for Government counsel or myself. I take it the Court will take judicial knowledge of them.

The Court: Yes.

Mr. Wild: "XVI. The Court in the aforesaid decision. . . ."

The Court: Well, is it necessary to read all that?

Mr. Wild: No, your Honor.

The Court: Is there any objection to the admission of that?

Mr. Atherton: The Government interposes the same objection, your Honor, to the text of these paragraphs as it did to the original introduction of the findings of fact.

The Court: As immaterial and irrelevant?

Mr. Atherton: Same reasons.

The Court: Overruled.

Mr. Atherton: I'd like the record to show that the Government notes an exception to the ruling.

Mr. Wild: And the same in this paragraph XVI; there are a number of findings which your Honor will read and you don't need now. "No. XVII. American Factors, Limited, paid from time to time all of the expenses of the Hackfeld litigation which totaled $568,607.76; that these payments were [52] carried by American Factors, Limited on its records as deferred items. The amounts . . ."

The Court: What is meant by that?

Mr. Wild: That is that they weren't liable for them at that time. They were merely making payments and the question on a deferred item as to whether it is an expense or charge is withheld until later. In other words, it is a deferred item.

The Court: As it paid that out, the entry would go through their cash book? And what would it be in the ledger?

Mr. Wild: Well, it would be Hackfeld litigation expense, and it is deferred expense, and then it was billed out to the other defendants right away.

The Court: Oh, yes.

Mr. Wild: If I will read the rest of the paragraph I think it will explain it. Actually there, your Honor, these defendants go into an agreement where Factors would handle the money and they would get it into Factors under that other agreement, and then it all was held in suspense to await the final determination of the litigation.

Mr. Atherton: Excuse me a minute. Would you like to correct that statement? I don't think it is altogether accurate, Mr. Wild. The stipulation says the amounts were paid.

Mr. Wild: That's right. [53]

Mr. Atherton: As far as American Factors were concerned, for bookkeeping purposes it carried the amount despite their payment in a suspense account.

Mr. Wild: That's right.

Mr. Atherton: But I'm afraid that your statement, if the reporter will read it back, maybe gave the erroneous impression that they were not to be paid ultimately.

Mr. Wild: Under the agreement they were paid as they currently went along, but they were carried to suspense because of the agreement of the other parties, already in evidence, that they were going to pay all expenses and litigation expenses, and as these expenses were collected or amounts were paid, the parties who signed that agreement were billed for them, and they reimbursed the American Factors. We will go right on with the stipulation, and it will explain it.

Mr. Atherton: I just want it clear.

Mr. Wild: "The amounts so paid and the years in which payment thereof were made were as follows:"

And then there is a tabulation which shows the years.

The Court: Yes, I have looked at that. Now, I would have thought that it would be more understandable to have shown the account as going directly from the account books of the American Factors than to have compiled this statement.

Mr. Wild: Well, these statements, I might say, came [54] from Government counsel, and they came also from data which we had furnished. And we have those other statements which will be adduced in evidence, your Honor.

The Court: All right.

Mr. Wild: And this stipulation, as I understood it, was to have before your Honor, at your hands, a memorandum of the thing.

The Court: All right.

Mr. Wild: I have here, I might say, a summary of the accounts and a summary of the accounts as shown in the books, and a summary that shows these other payments in the years in which they were made, which I promised counsel for the Government I am going to adduce in evidence here, your Honor.

"During the early period of the Hackfeld litigation $396,812.50 of the above expenses was prorated among twenty-two of the Hackfeld co-defendants in proportion to their shareholdings in American Factors, Limited, as shown below, pursuant to the agreement signed by defendants other than American Factors, Limited, a copy of which, marked Exhibit 1, is annexed hereto and made a part hereof, and the taxpayer collected from these stockholders at the times shown below the amounts stated opposite their names, to wit:".

And then comes a list which I don't need to read, I take it, of the items which were billed and collected in 1924, '25——

The Court: Well, wasn't there a couple of those signers [55] of the agreement who died and are not included in this?

Mr. Wild: Yes, your Honor.

The Court: Were collections made from them?

Mr. Wild: I don't—just a second—there may have been one.

The Court: Their estates would have been liable for it.

Mr. Wild: Well, your Honor, for anyone who signed the agreement—you see, there were certain ones that had died between the reorganization of American Factors and the threatened litigation, and didn't sign the agreement. Of those who signed the agreement——

The Court: All paid?

Mr. Wild: ——all paid. So that under that agreement—as your Honor remembers, all the expenses of the litigation that the so-called steering committee approved or adopted were all to be paid by them. And that was done. So I don't need to repeat this. It shows the amounts in December, 1924, August '25, December and January '26. And it shows that they were billed by American Factors during these periods of time with items that totaled $396,812.50 on account of Hackfeld litigation expenses. One time the American Factors had on hand more money than had been incurred for expenses or had been paid, been billed for expenses at that time.

"In the year 1932 after the conclusion of the Hackfeld [56] litigation, the taxpayer repaid to the above-named stockholders . . ." That is, the taxpayer should mean American Factors, Limited. ". . . repaid to the above-named stockholders, except S. W. Wilcox who had died in the meantime, the amounts previously collected from them. Taxpayer repaid in 1932 to the heirs of S. W. Wilcox, deceased, the amounts stated opposite their names, to wit:".

Now, it shows that S. W. Wilcox in the first table had paid in $16,187.50, and the reimbursement to his payers was $16,187.50,——

The Court: Yes.

Mr. Wild: "Repayment of the $396,812.50 was authorized by a resolution adopted by the board of directors of the taxpayer at a meeting thereof held on March 4, 1932. A true copy of an excerpt from the minutes of the annual meeting of the stockholders of American Factors, Limited, held March 4th, 1932 containing that resolution is annexed as Exhibit 2 and made a part hereof."

Mr. Atherton: Your Honor, I'd like to ask the reporter to read the statement by Mr. Wild that preceded his reading of this paragraph at the bottom of page 15. I move that that statement be stricken. It purports to be a statement of fact.

The Court: Well, I would take the offhand view that that is a part of the opening statement. [57]

Mr. Wild: Yes, your Honor.

The Court: And that is something that he would expect to prove later.

Mr. Wild: That is it, your Honor. I merely made it because I understood it was an answer to your Honor's inquiry.

Mr. Atherton: Well, if it is admitted for that limited purpose, very well, your Honor. I will withdraw my objection.

The Court: Let the record show that.

Mr. Atherton: No objection to that paragraph.

The Court: This shows that the stockholders'

meeting of March 4th passed a resolution annexed as Exhibit 2, March 4th, that it was before the Supreme Court of the United States, that they denied certiorari?

Mr. Wild: That is right. It was after——

The Court: Let's see this Exhibit 2. Where is it?

Mr. Wild: Shall I read that?

"Excerpt from Minutes of Annual Meeting of Stockholders of American Factors, Limited, Held March 4th, 1932.

'President Bottomley addressed the stockholders as follows:

"I should like to refer to the paragraph in my report which deals with the case of Isenberg et al. versus Sherman et al., or the so-called Hackfeld litigation, the expenses of which have been advanced by certain [58] of the individual defendants pending the decision of the Court as to whether their acts were legal and the transaction a valid one. These defendants, as officers and large stockholders, participated in the organization of American Factors, Limited, and were made co-defendants with American Factors, Limited, in the litigation.

"The litigation in California, as you all know, complained of the acts of these individual defendants, as well as the acts of American Factors, Limited, in connection with the reorganization of Hackfeld & Co. and the organization of American Factors, Limited, and the suit brought in New York asked the Court to rescind the entire transaction and to charge upon the assets of American Factors,

Limited, the claims of the plaintiffs to an amount of $10,000,000 and upwards.

"The claims made in these two suits show beyond any possibility of doubt that the whole structure on which American Factors, Limited, was founded was attacked by this litigation and that the defendants in the suit were attacked solely because they had assisted in the formation of American Factors, Limited. Accordingly, I recommend to this meeting of Stockholders that they approve of the payment by the Company of the litigation expenses rather than have them remain as a charge [59] against those who, under the direction of the Alien Property Custodian, were responsible for the formation of your Company.

"The Undivided Profits and Reserves of Hackfeld & Co. standing on the books of that Company as of August 18th, 1918, the date on which Hackfeld & Co. was taken over by the American Factors, Limited, were set aside as a reserve to meet any contingent claims on American Factors, Limited, or unknown liabilities of Hackfeld & Co., and I believe that the balance of this reserve could justly and properly now be used in the payment of these expenses so that the actual earnings of the Company would not be affected thereby."

President Bottomley stated further that this matter was taken up with Mr. Oscar Sutro, attorney for the Company during the litigation, and that he feels that the whole structure of the Company was involved in the claims made by Mr. Nylen and

that the litigation expenses should be paid by the Company.

An opinion of Messrs. Smith, Wild and Beebe, attorneys for the Company on this subject, dated March 3rd, 1932, which opinion is filed with the records of the Secretary of the Company and made a part of these minutes, was then read to the Stockholders, this opinion reciting the view of the attorneys that it is within the powers [60] of the corporation to make reimbursement to the individual defendants in the Hackfeld Litigation, and, further, that the corporation is under moral obligation to make such reimbursement upon proper authorization of the Stockholders.

Mr. W. F. Frear thereupon offered and moved the following resolution, to wit:

Resolved: That the officers of this corporation be and they are hereby authorized and directed to pay on behalf of the corporation the costs and expenses of the litigation known as the Hackfeld litigation in the courts of Hawaii, San Francisco, New York and elsewhere.

The motion for the adoption of the resolution was seconded by Mr. F. L. Bellows and unanimously carried and the resolution thereby duly adopted.' "

Mr. Atherton: The Government objects to the introduction of that exhibit on the basis that it is hearsay, incompetent, irrelevant and immaterial. And the only thing that the Government would not object to is that the refund amount of the $396,000 was duly authorized by the board of directors on that date.

The Court: Well, you think there is other matter in this resolution that shouldn't be put in as evidence?

Mr. Atherton: I believe so, your Honor.

The Court: Merely the substantial fact that the stockholders [61] had a meeting, and at a meeting at this time did authorize a refund?

Mr. Atherton: That is all that is material and relevant here. Now, if counsel wants to offer in evidence the opinion rendered to the tax payer, why, I have no objection to that going in.

Mr. Wild: I must confess, your Honor, counsel for the Government asked me to get this record, asked me to attach it to the stipulation. I told him I'd have our letter here. I put in exactly what he wanted. And I am surprised now that he has made any objection to it. I told him that I'd have our letter to present. It seems to me it is all part of the Res gestae, your Honor, clearly.

The Court: The objection is noted and overruled.

Mr. Atherton: Exception, your Honor.

Mr. Wild: I was surprised. Then the next paragraph:

"XVIII. In its federal income tax return for the taxable year 1932, the taxpayer took the entire amount of $568,607.76 of Hackfeld litigation expenses as a deduction in computing its taxable net income, and the Commissioner of Internal Revenue disallowed the entire amount claimed as a deduction."

Mr. Atherton: No objection.

Mr. Wild: May we offer stipulation No. 2 in evidence? I think that would be P-5, your Honor.

The Court: Well, it has already been read and it is attached to this stipulation, and as I remember, the stipulation was offered in evidence.

Mr. Wild: Yes, your Honor.

The Court: And it is now accepted in evidence subject to the objections heretofore made and as ruled on with the exceptions reserved.

Mr. Atherton: I'd also like to ask your Honor that the record show that in accepting it in evidence over the Government's objections heretofore made, that the admissibility be limited to the statements literally made in the stipulation of facts and the documents annexed thereto, and not those supplemented by counsel.

The Court: Well, that would follow as a matter of course. The transcript of the proceedings here, in connection with the reading, would show perhaps many extraneous remarks. What do you want this numbered as, this stipulation?

Mr. Wild: I think that would be P-5, your Honor. According to my record that would be the fifth exhibit.

The Court: The stipulation is No. 2?

Mr. Wild: Two.

The Court: As qualified by earlier statements of the Court, accepted in evidence as Exhibit P-5.

(The document referred to was received in evidence as Plaintiff's Exhibit P-5.) [63]

PLAINTIFF'S EXHIBIT P-5

(Admitted)

In the United States District Court for the Territory of Hawaii

Civil Action No. 419

AMERICAN FACTORS, LIMITED, a Hawaiian Corporation,

Plaintiff,

vs.

AGNES M. KANNE, Executrix Under the Will and of the Estate of Fred H. Kanne, Collector of Internal Revenue of the United States for the District of Hawaii,

Defendant.

STIPULATION II

SMITH, WILD, BEEBE & CADES.
U. E. WILD,

Attorneys for Plaintiff.

LELAND T. ATHERTON,
Special Assistant to the
Attorney General,
Tax Division,
Department of Justice,
Washington, D. C.,

Attorney for the Defendant.

Plaintiff's Exhibit P-5—(Continued)

It is hereby stipulated by and between the parties hereto through their respective attorneys that the following statements of fact shall be considered as true, and that either party may offer in evidence, oral testimony or any additional evidence, documentary or otherwise not inconsistent with the facts herein stipulated.

I.

When the United States entered the First World War, H. Hackfeld & Company, Limited, (hereinafter referred to as "Hackfeld Co.") was an Hawaiian corporation, which was then conducting and had conducted for many years prior thereto a sugar plantation agency, general merchandise store and other businesses and was a large factor in the Hawaiian sugar industry and in other businesses in the Territory of Hawaii; that Hackfeld Co. had been and was at that time controlled by German interests; that on or about January 28, 1918, and during March, 1918, the Alien Property Custodian of the United States seized the stock of Hackfeld Co., owned by German Nationals and gained control either directly or indirectly of approximately Sixty-eight and one-half (68½) per cent of its capital stock.

II.

Prior to January 28, 1918, the business of Hackfeld Co., had been seriously disrupted as a consequence of restrictions placed upon it by the Al-

Plaintiff's Exhibit P-5—(Continued)

lied Governments as the result of its German affiliations and those of its stockholders. A plan for the reorganization of said company was formulated in the office of the Alien Property Custodian of the United States of America, (hereinafter referred to as "Alien Property Custodian"), which plan as thereafter perfected is fully set forth in a resolution adopted by the stockholders of that company on July 19, 1918, a copy of which is attached to the Answer of the Defendants, Respondents (exclusive of the Alien Property Custodian) filed in Isenberg et al., Plaintiffs, Complainants v. George Sherman et al., Defendants, Respondents, being No. 149913 Dept. No. 2 in the Superior Court of the State of California, in and for the City and County of San Francisco, (hereinafter referred to as the "California Case") as Exhibit A thereof.

III.

In the decision filed on March 16, 1926, in the California Case referred to in Paragraph II supra, the Court in its Findings of Fact found in part as follows:

"VIII.

The organization of American Factors, Limited, as a new corporation to take over the business and assets of H. Hackfeld & Co., Ltd., as a going concern and whose stock, or trust certificates therefor, was to be sold to American citizens, was an integral part of said plan.

* * *

Plaintiff's Exhibit P-5—(Continued)

"X.

It was the opinion of the Alien Property Custodian at all times after the seizure of said stock that the sale of the business and assets of H. Hackfeld & Co., Ltd., as a going concern and the preservation and continuance of its business rather than its disintegration were for the best interests of the stockholders of said corporation. He was also of the opinion and so determined that the best interests of the public and the proper administration of the Trading with the Enemy Act required such preservation and continuance of said business.

"XI.

It was the opinion and judgment of the Alien Property Custodian that it was necessary for the continued welfare and prosperity of said business and to public confidence in said business and to the successful consummation of his plan for its reorganization, that persons in Honolulu who were conversant with business of a similar nature should assume its direction. Such opinion and judgment were reasonable and proper. The defendants named in paragraph XX* of the complaint, other than the defendants H. L. Scott, Richard H. Trent and Trent Trust Company, Ltd., organized a joint subscription, substantially all the joint subscribers to which were known to and reported to the Alien Property Custodian, for the purchase of at least

*Consisting of 23 persons and corporations.

Plaintiff's Exhibit P-5—(Continued)

one-half of the stock of the American Factors, Ltd., to the end that they might control and direct said American Factors, Ltd., in continuing the business of H. Hackfeld & Co., Ltd., and retain the agencies theretofore held by it, and so that the public invited to subscribe to the stock of American Factors, Ltd., might do so in reliance upon the management of said business by representatives of corporations conversant with and theretofore highly successful in similar business, and to the end that said public having so subscribed, should be protected in its investment.

* * *

About 637 persons subscribed to and became stockholders of American Factors, Ltd.

* * *

"XXXIV.

Long prior to the meeting of July 19th, 1918, the Alien Property Custodian was advised that the defendants, Castle & Cooke, Limited, Alexander & Baldwin, Limited, Matson Navigation Company, C. Brewer & Company, Limited, Welch & Company, J. B. Atherton Estate, Limited, Henry P. Baldwin, Limited, Charles M. Cooke, Limited, G. N. Wilcox, S. W. Wilcox, A. S. Wilcox, Wallace M. Alexander, George Sherman, J. F. Lowrey, F. C. Atherton, R. A. Cooke, and others, proposed to purchase more than one-half of the stock proposed to be issued by the new corporation which was to suc-

Plaintiff's Exhibit P-5—(Continued)

ceed to the business of H. Hackfeld & Co., Ltd. The Alien Property Custodian was well acquainted with the identity and business connections of said defendants whose names were furnished to him.

It was the aim and purpose of the Alien Property Custodian, stated and believed by him to be for the best interests of said corporation and its stockholders, and it was in fact to the best interests of said corporation and its stockholders, that a large portion of the trust certificates mentioned in said stockholders' resolution of July 19, 1918, should be purchased by persons familiar with the sugar agency business in the Hawaiian Islands, and by persons who could properly and efficiently manage said business, and in whom the subscribing public would have confidence. To that end it was the desire of the Alien Property Custodian and his plan, that a large portion of said trust certificates should be purchased by those persons and corporations who were then engaged in the plantation agency business in Hawaii.

It was the purpose of the Alien Property Custodian to induce the defendant firms who were then engaged in the sugar agency business, to subscribe to said trust certificates in order to insure the success and continuance of the business of H. Hackfeld & Co., Ltd., or the successor corporation to be formed. It was believed by the Alien Property Custodian that in that manner he could best secure the prosperity of the corporation which was

Plaintiff's Exhibit P-5—(Continued)

to take over the business and assets of H. Hackfeld & Co., Ltd., under said plan adopted by the stockholders of H. Hackfeld & Co., Ltd., on July 19th, 1918. It was the opinion of the Alien Property Custodian that the public of Hawaii would more readily subscribe to the trust certificates to be issued under said plan if the control and management of said successor corporation were in the hands of the defendant firms then engaged in the sugar agency business in the Territory of Hawaii. The opinion and belief of the Alien Property Custodian in these respects were reasonable.

The Alien Property Custodian therefore desired the purchase by said defendants and their associates in this finding first above named and referred to, of a large part of the trust certificates representing the stock of American Factors, Ltd., and acquiesced in the allotment to said defendant firms and their associates upon their subscriptions of one-half of said trust certificates."

IV.

The subscription for trust certificates for shares of American Factors, Ltd., is attached to the Answer filed in the California case as Exhibits B and C thereof and shows that the participants subscribed to a total of twenty-seven thousand (27,000) shares of stock in blocks of stock, ranging from one hundred (100) to two thousand five hundred (2,500) shares, conditioned upon the allotment of a mini-

Plaintiff's Exhibit P-5—(Continued)

mum of twenty-five thousand (25,000) shares to the group; that the joint subscription agreement was accepted for a total of twenty-five thousand (25,000) shares and trust certificates were issued to and paid for by the said signers of the said joint subscription agreement for the total of said twenty-five thousand (25,000) shares; that trust certificates, representing the other twenty-five thousand (25,000) shares of the Plaintiff's capital stock were allotted to and paid for by approximately six hundred and fourteen (614) other persons and corporations.

V.

That trust certificates, representing fifty thousand (50,000) shares of the capital stock of Plaintiff, were issued and sold for the price of one hundred and fifty dollars ($150.00) per share and the total stated consideration of seven million, five hundred thousand dollars ($7,500,000.00) was duly paid in cash or United States Liberty Bonds at par to Hackfeld Co., and in exchange therefor Hackfeld Co., conveyed all of its assets and businesses as a going concern on August 20, 1918 to the Plaintiff and Plaintiff assumed all liabilities of Hackfeld Co. and of the business, and Plaintiff thereafter continued the business as a going concern.

VI.

That included among the subscribers participating in the joint subscription agreement were persons who were incorporators of American Factors,

Plaintiff's Exhibit P-5—(Continued)

Limited, and persons who subsequently became officers and directors of that corporation or of Hackfeld Co., or who otherwise participated in the business and affairs of Plaintiff.

VII.

That about June 1924, the then directors of American Factors, Limited were informed that former stockholders of Hackfeld Co., then dissolved, threatened to initiate litigation; that at that time it was not known what form the litigation would take nor who would be the Defendants; that the Board of Directors of American Factors, Limited, after consideration, authorized its president to secure counsel for American Factors, Limited, to prepare for and to conduct the defense in the threatened litigation; that American Factors, Limited procured the services of attorneys to represent it in the threatened litigation.

VIII.

Prior to the filing of the suits in the threatened litigation above mentioned, twenty-one of the twenty-three persons and corporations who had joined in the joint subscription agreement for the shares of stock of American Factors, Limited, described in paragraph IV of this stipulation, entered into a written agreement under date of July 28, 1924, a true copy of which is annexed hereto as Exhibit 1 and made a part hereof, wherein they agreed to prorate on an original per share basis the

Plaintiff's Exhibit P-5—(Continued)

expenses of the aforesaid threatened litigation if they were joined as defendants therein. Two of the individuals who had joined in the joint subscription agreement hereinbefore described did not participate in the agreement of July 28, 1924, to share the expenses of the threatened litigation because they had died. American Factors, Limited was not a party to the agreement of July 28, 1924.

IX.

That the suit of J. C. Isenberg, et al., Plaintiffs, Complainants, hereinafter called "Hackfeld Plaintiffs" v. George Sherman . . . American Factors, Limited, et al., Defendants, Respondents, hereinafter called "Hackfeld Defendants", and which litigation, hereinafter called the "Hackfeld litigation", was commenced in August and September 1924; that identical complaints in the Hackfeld litigation were filed in the Circuit Court of the First Judicial Circuit, Territory of Hawaii, and in the Superior Court of the State of California in and for the City and County of San Francisco; that by stipulation between the parties the case filed in the California court was tried; that American Factors, Limited was one of the defendants named in the Hackfeld litigation and the twenty-three corporations and persons, including the representatives of the estates of the two deceased persons who had signed the joint subscription agreement, were joined as Hackfeld Defendants.

Plaintiff's Exhibit P-5—(Continued)

X.

The Supreme Court of California, as reported in 212 Cal. 454, 461; 298 Pac. 1004 at page 1006, said of the aforesaid complaint:

". . . The purport of the complaint is to require the individual and corporate respondents to account to complainants for all matters and things concerning the transfer and sale of the assets of H. Hackfeld & Company, Limited, to American Factors, Limited, an Hawaiian corporation, organized for the express purpose of taking over the business and assets of said H. Hackfeld & Company Limited. The gist of the complaint affirms the sale and alleges that the sale and transfer were the result of conspiracy, collusion, and fraudulent connivance on the part of certain of the respondents, whereby they secured the assets and profitable business of H. Hackfeld & Company, Limited, at a price far below its alleged intrinsic value, in fraud of and to the financial injury of complainants. The object of the suit is to require respondents to account to complainants for the transfer and sale of the assets of H. Hackfeld & Company, Limited, to American Factors, Limited, and to account for the difference between $7,500,000, the price at which the assets were sold, and the actual value of the assets of the corporation at the date of transfer, which appellants claim to be $17,500,000. The Alien Property Custodian of the United States was made a respondent, but no relief or judgment is sought against him,

Plaintiff's Exhibit P-5—(Continued)

it being alleged that his interest as trustee for certain of the stockholders 'is identical with the interest of the complainants herein,' but not having joined as a complainant, he is joined as a respondent, so that, as such trustee, he may properly receive the benefits of any judgment which may be entered herein.' Certain other persons are made formal respondents for the same reasons."

XI.

That the complaint in the aforesaid action, in Paragraph XXXVI thereof, in substance, alleged that American Factors, Limited took and received all of the assets of Hackfeld Co., with full knowledge of all the facts and circumstances set forth in the complaint, and with full knowledge of and concerning the rights and equities of the stockholders of said Hackfeld Co., and did thereafter handle the said assets and conduct said business in trust for the protection by it of the rights and equities of said stockholders and the complainants, and said American Factors, Limited did so mismanage said business and did so improperly handle said assets as to cause great damage to said assets and business and great injury to the rights and equities of said stockholders and complainants, and that the American Factors, Limited was a party to the fraudulent scheme and the conspiracy therein alleged, and holds said business and said property in trust to protect the rights and equities of com-

Plaintiff's Exhibit P-5—(Continued)

plainants, and that by its mismanagement of said business and said assets, it has caused further and additional loss to said business and to said stockholders of said Hackfeld Co., and to the complainants in the sum of upwards of Two and One-Half Million Dollars in addition to all other damage and loss suffered by complainants.

XII.

The prayers in the above referred to complaint, among others, included the following:

"8. That this Court do make and enter its order ordering and directing the Respondents A. W. T. Bottomley, R. A. Cooke, C. R. Hemenway, G. P. Wilcox, F. C. Atherton, F. J. Lowrey, R. H. Trent and George Sherman, to make a full and complete accounting of and concerning all matters and things having to do with their doings as officers and directors of American Factors, Ltd., and as such as fiduciaries of the rights and equities of Complainants herein, in and attaching to the assets and business of said corporation, as more fully hereinabove set forth;

9. That this Court do make and enter its order ordering and directing the Respondent American Factors, Ltd., that it do hold that part and portion of the assets and business belonging to it, said American Factors, Ltd., and representing the interest in said corporation of the Respondents named in paragraph XX of this Bill of Complaint in trust

Plaintiff's Exhibit P-5—(Continued)

for Complainants herein, subject to the application of said assets to the satisfaction of such judgment as may be entered herein against said Respondents in this paragraph of Complainant's prayer hereinabove named and referred to. And that it do hold all of its said assets subject to their application to such judgment as may be rendered herein against it, said Respondent American Factors, Ltd.;

10. That this Court do make and enter its order ordering and directing Respondents named in paragraph XX of this Bill of Complaint, that they, said Respondents, do hold the stock of American Factors, Ltd., purchased and held by them as more fully hereinabove set forth in trust for Complainants herein, subject to the application of said stock to the payment of such judgment as may be entered herein against said Respondents named in paragraph XX of this Bill of Complaint;

* * * *

12. That this Court do make and enter its judgment against the Respondents named in paragraph XX of this Bill of Complaint, and against the Respondent American Factors, Ltd., and in favor of the Complainants in such manner as to the Court may seem just and proper and for such an amount as will adequately and completely compensate and reimburse said Complainants for the injury, loss and damage suffered by them, said Complainants, by rea-

Plaintiff's Exhibit P-5—(Continued)

son of the fraud perpetrated by said Respondents as more fully hereinabove set forth;

* * * *

19. That this Court do make and enter its judgment against the Respondents A. W. T. Bottomley, R. A. Cooke, C. R. Hemenway, G. P. Wilcox, F. C. Atherton, F. J. Lowrey, R. H. Trent and George Sherman on an accounting to be made by said Respondents as officers and directors of American Factors, Ltd., and as fiduciaries to protect the rights and equities of Complainants herein in and attaching to the assets and properties of said corporation, for such an amount as it may appear that Complainants have been injured by reason of the mismanagement and breaches of trust committed by said Respondents as said fiduciaries;

20. That this Court do make and enter its judgment against the Respondent American Factors, Ltd., for such an amount as it may appear that Complainants have been injured by reason of injury to their equities and rights attaching to the properties of said corporation through mismanagement and breach of fiduciary duty committed by said Respondent corporation."

XIII.

That the attorneys employed by American Factors, Limited investigated the facts and matters pertaining to the Hackfeld litigation and prepared

Plaintiff's Exhibit P-5—(Continued)

a joint answer on behalf of American Factors, Limited and the other Hackfeld Defendants, except the Alien Property Custodian and the nominal Defendants and signed and filed the answer on behalf of such Hackfeld Defendants. A separate answer was filed on behalf of the Alien Property Custodian.

XIV.

The trial judge filed the following memorandum on January 6, 1926:

"I am of the opinion that (1) no actual fraud on the part of respondents was shown; (2) no constructive fraud existed; (3) the price paid was adequate; (4) the suit is not barred by the Hawaiian statute of limitations; (5) plaintiffs were not guilty of laches. Frank J. Murasky, Judge."

The trial judge's memorandum quoted above is taken from the report of the Supreme Court of California in the case of Isenberg v. Sherman, 212 Cal. 454, 461; 298 Pac. 1004. On March 16, 1926 a decision comprising Findings of Fact and Conclusions of Law was filed, and on January 31, 1927, judgment was entered for the defendants and against the complainants.

XV.

An appeal was perfected by the plaintiffs in the aforesaid equity suit (the California Case) to the Supreme Court of the State of California, where further hearings and arguments were had in the

Plaintiff's Exhibit P-5—(Continued)

matter on appeal, and on April 30, 1931, the California Supreme Court rendered its opinion affirming the judgment of the trial court. The opinion of the Supreme Court of California is reported in 212 Cal. 454, 298 Pac. 1004. On May 28, 1931, the Supreme Court of California denied a petition for rehearing filed by the Hackfeld plaintiffs. The opinion of the Supreme Court of California denying this petition for rehearing is reported in 212 Cal. 507, 299 Pac. 528. Thereafter a motion to recall the remittitur issued to the County Clerk of San Francisco was filed by the complainants on August 26, 1931, and the Supreme Court of California in a decision handed down on January 29, 1932, denied complainants' motion to recall the remittitur. The decision of the Supreme Court of California giving a reason for the denial of the motion to recall the remittitur is reported in 214 Cal. 722, 7 P. 2d 1006. On April 25, 1932, the Supreme Court of the United States denied a petition filed by the Hackfeld plaintiffs for writ of certiorari to the Supreme Court of California, 286 U.S. 547.

XVI.

The Court in the aforesaid decision filed on March 16, 1926, among others, made the following findings of fact:

"XL.

On July 19, 1918, August 20, 1918, and at all times during the year 1918, the entire net assets and busi-

Plaintiff's Exhibit P-5—(Continued)

ness of H. Hackfeld & Co., Ltd., whether as a going concern or by way of liquidation or otherwise, were worth no more than the amount realized from the sales pursuant to the stockholders' resolution of July 19, 1918, of the trust certificates therein mentioned. Neither the entire capital stock of American Factors, Ltd., nor all said trustees' certificates were worth at the time they were sold pursuant to said resolution or at any time prior to their sale, more than was actually received therefor, to wit, $7,500,000, which was paid partly in cash and partly in bonds of the United States and in accordance with said resolution.

The 50,000 fully paid shares of stock of American Factors, Ltd., mentioned in said stockholders resolution and subject to all the terms and conditions thereof, were at the time that they were issued to H. Hackfeld & Co., Ltd., in exchange for the property in this finding referred to, an adequate, just and fair price to H. Hackfeld & Co., Ltd., for all and singular the property, business, rights, contracts, agencies, franchises, credits, accounts and other interests of every kind of said H. Hackfeld & Co., Ltd., and the good will thereof as a going concern, subject to its outstanding debts, obligations and liabilities, including income taxes for the year 1918 up to the date of transfer of said property, etc., to said American Factors, Ltd.

The price of $150. per share, payable partly in cash and partly in Liberty Bonds as provided in

Plaintiff's Exhibit P-5—(Continued)

said stockholders' resolution and at which trust certificates representing stock of American Factors, Ltd., were sold, was an adequate price, and was a just and fair price for said trust certificates and for said stock and for the business and assets of H. Hackfeld & Co., Ltd. It is also the fact that a higher price could not have been obtained for the said assets and business of H. Hackfeld & Co., Ltd., or for the stock of H. Hackfeld & Co., Ltd., or of American Factors, Ltd., or for the trust certificates, than the price that was actually realized.

Each and every person who was a stockholder of H. Hackfeld & Co., Ltd., on July 19, 1918, has received by way of distributions from the proceeds of the trust certificates representing stock of American Factors, Ltd., sold pursuant to said stockholders' resolution of July 19, 1918, a just, fair and adequate price for his respective shares of stock in H. Hackfeld & Co., Ltd., owned by him on July 19, 1918, to wit in excess of $194.50 for each share of common stock and $100. plus accrued dividends for each share of preferred stock.

H. Hackfeld & Co., Ltd., did not at any time in the year 1918 or thereafter own property, real and personal, in the Territory of Hawaii, or elsewhere, which with or without the business of said corporation was of the value of upwards of $17,500,000, or of any value which after deducting the liabilities of said corporation was in excess of the price herein

Plaintiff's Exhibit P-5—(Continued)

found to have been a fair and just price for the business and assets of said corporation.

* * * *

XLIV.

None of the plaintiffs whose stock in H. Hackfeld & Co., Ltd., had not been seized by the Alien Property Custodian was paid any other consideration than cash in the liquidation of the stock of said corporation. The Liberty Bonds paid for said trust certificates were, with the consent of the Alien Property Custodian, turned over to the Alien Property Custodian at par in payment and liquidation of the stock of H. Hackfeld & Co., Ltd., theretofore seized by him.

XLV.

The defendants did not, nor did any of them, reap any benefits from said reorganization or from the sale of said stock of American Factors, Ltd., or the trust certificates therefor, or from the purchase thereof by themselves except such benefits as accrued to every purchaser of said trust certificates.

* * * *

L.

American Factors, Ltd., received the business and assets of H. Hackfeld & Co., Ltd., and issued in exchange therefor its entire authorized capital stock, consisting of 50,000 shares, which was received by H. Hackfeld & Co., Ltd., in full payment for said

Plaintiff's Exhibit P-5—(Continued)

business and assets in accordance with said resolution of the stockholders of H. Hackfeld & Co., Ltd., adopted July 19, 1918.

Pursuant to said resolution the trust certificates issued for the American Factors, Ltd., stock were in the month of July, 1924 duly exchanged for stock of American Factors, Ltd."

XVII.

American Factors, Limited, paid from time to time all of the expenses of the Hackfeld litigation which totaled $568,607.76; that these payments were carried by American Factors, Limited on its records as deferred items. The amounts so paid and the years in which payment thereof were made were as follows:

Year Paid	Amount Paid
1924	$108,450.65
1925	198,114.32
1926	149,117.30
1927	6,255.49
1928	12.27
1929	15,852.83
1930	(1,707.28)*
1931	4,519.68
1932	87,992.50
	$568,607.76

During the early period of the Hackfeld litigation $396,812.50 of the above expenses was prorated among twenty-two of the Hackfeld co-defendants in

* this amount reflects a fee of $2,539.28 charged in error December 24, 1929.

Plaintiff's Exhibit P-5—(Continued)

proportion to their shareholdings in American Factors, Limited, as shown below, pursuant to the agreement signed by defendants other than American Factors, Limited, a copy of which, marked Exhibit 1, is annexed hereto and made a part hereof, and the taxpayer collected from these stockholders at the times shown below the amounts stated opposite their names, to wit:

Plaintiff's Exhibit P-5—(Continued)

	No. Shares	Dec. 1924	Aug.-Oct. 1925	Dec. & Jan. 1925 1926	Total
C. Brewer & Co.	2,300	$10,350.00	$ 8,050.00	$ 21,850.00	$ 40,250.00
Alexander & Baldwin	2,300	10,350.00	8,050.00	21,850.00	40,250.00
H. P. Baldwin, Ltd.	2,300	10,350.00	8,050.00	21,850.00	40,250.00
A. W. T. Bottomley	1,000	4,500.00	3,500.00	9,500.00	17,500.00
G. P. Wilcox	500	2,250.00	1,750.00	4,750.00	8,750.00
G. N. Wilcox	1,850	8,325.00	6,475.00	17,575.00	32,375.00
R. A. Cooke	25	112.50	87.50	237.50	437.50
F. J. Lowrey	500	2,250.00	1,750.00	4,750.00	8,750.00
C. M. Cooke, Ltd.	1,000	4,500.00	3,500.00	9,500.00	17,500.00
E. D. Teeney	100	450.00	350.00	950.00	1,750.00
Castle & Cooke	2,300	10,350.00	8,050.00	21,850.00	40,250.00
F. C. Atherton	250	1,125.00	875.00	2,375.00	4,375.00
J. B. Atherton Estate	600	2,700.00	2,100.00	5,700.00	10,500.00
S. W. Wilcox	925	4,162.50	3,237.50	8,787.50	16,187.50
W. M. Alexander	717	.....	5,736.00	6,811.50	12,547.50
Alexander Prop. A/c	208	.....	1,664.00	1,976.00	3,640.00
Matson Nav. Co.	2,300	.....	18,400.00	21,850.00	40,250.00
W. P. Roth	100	.....	800.00	950.00	1,750.00
Andrew Welch	100	.....	800.00	950.00	1,750.00
Welch & Co.	2,300	.....	18,400.00	21,850.00	40,250.00
George Sherman	925	4,162.50	3,237.50	8,787.50	16,187.50
W. F. Dillingham	75	.....	600.00	712.50	1,312.50
	22,675	$75,937.50	$105,462.50	$215,412.50	$396,812.50

Plaintiff's Exhibit P-5—(Continued)

In the year 1932 after the conclusion of the Hackfeld litigation, the taxpayer repaid to the above-named stockholders, except S. W. Wilcox who had died in the meantime, the amounts previously collected from them. Taxpayer repaid in 1932 to the heirs of S. W. Wilcox, deceased, the amounts stated opposite their names, to wit:

Mrs. S. W. Wilcox	$ 5,395.83
G. P. Wilcox	2,158.33
Etta W. Sloggett	2,158.33
Elsie H. Wilcox	2,158.33
Mabel I. Wilcox	2,158.33
Samuel W. Wilcox	719.45
Bishop Trust Company, Guardian of Estate of Margaret L. Wilcox	719.45
Bishop Trust Company, Guardian Estate of Martha W. Wilcox	719.45
	$16,187.50

Repayment of the $396,812.50 was authorized by a resolution adopted by the Board of Directors of the taxpayer at a meeting thereof held on March 4, 1932. A true copy of an excerpt from the minutes of the annual meeting of the stockholders of American Factors, Limited, held March 4th, 1932 containing that resolution is annexed as Exhibit 2 and made a part hereof.

XVIII.

In its federal income tax return for the taxable year 1932, the taxpayer took the entire amount of $568,607.76 of Hackfeld litigation expenses as a deduction in computing its taxable net income, and

Plaintiff's Exhibit P-5—(Continued)

the Commissioner of Internal Revenue disallowed the entire amount claimed as a deduction.

SMITH, WILD, BEEBE & CADES,

/s/ U. E. WILD,

/s/ MILTON CADES,
Counsel for Plaintiff.

/s/ LELAND T. ATHERTON,
Special Assistant to the Attorney General, Tax Division, Department of Justice,
Counsel for Defendant.

/s/ RAY J. O'BRIEN,
United States Attorney for the District of Hawaii,
Counsel for Defendant.

Exhibit 1

The undersigned persons and corporations hereby agree each for himself and itself and not for the others of them with Allen W. T. Bottomley, C. R. Hemenway, F. C. Atherton and R. A. Cooke, provided only that he or it is made a party defendant or one of the parties defendant to the suit or suits hereinafter mentioned but not otherwise, to contribute and pay on demand such a proportion of all of the costs and expenses of every description hereinafter mentioned as the number of shares represented by the trust certificates hereinafter mentioned originally subscribed for and issued to them

Plaintiff's Exhibit P-5—(Continued)

bears to all of the shares represented by all of the said trust certificates subscribed for and issued to all of the subscribers hereto who are made parties defendant to the suit or suits hereinafter mentioned or any of them.

The costs and expenses hereinbefore mentioned are such as the said Allen W. T. Bottomley, C. R. Hemenway, F. C. Atherton and R. A. Cooke or any three of them acting in the name or on behalf of all of them have already paid or incurred or shall or may hereafter pay or incur in or about or in connection with the defense of any suit or suits which may be instituted against the undersigned or any of them upon or pursuant to the notice and demand made by J. F. Neylan as attorney for Mrs. Paul Isenberg and others, dated June 24th, 1924, or by any of the stockholders of H. Hackfeld & Company, Limited, an Hawaiian corporation which has been dissolved or is in process of dissolution by reason of or arising out of either the organization of the American Factors, Limited, or the sale and transfer of the assets of H. Hackfeld & Company, Limited, to the said American Factors, Limited, or the appointment of trustees by H. Hackfeld & Company, Limited, of the whole of the shares of the capital stock of American Factors, Limited; or the sale and issue by the said trustees of trust certificates of shares of the said American Factors, Limited, to sundry persons, firms and

Plaintiff's Exhibit P-5—(Continued)

corporations or any of the acts and deeds of the said trustees.

Dated, July 28th, 1924.

(signed)

Alexander & Baldwin, Ltd.
by J. Waterhouse, vice pres. .....2300 shares Cert. #3
Henry P. Baldwin, Ltd.
by J. Waterhouse, Agent .....2300 shares Cert. #34
C. Brewer & Company, Limited.
R. A. Cooke
Vice-President and Manager.....2300 shares Cert. #57
R. A. Cooke..... 25 shares Cert. #113
F. C. Atherton..... 250 shares Cert. #24
J. B. Atherton Estate, Ltd.
F. C. Atherton, Treasurer ..... 600 shares Cert. #26
Castle & Cooke, Ltd.
Chas. H. Atherton, Treasurer .....2300 shares Cert. 79
F. J. Lowery ..... 500 shares Cert. 341
G. Sherman ..... 925 do Ctfs. 493 & 543
Charles M. Cooke, Ltd.
C. H. Cooke, Managing Director.....1000 shares Ctf. #110
Allen W. T. Bottomley.....1000 shares Ctf. #45
G. P. Wilcox..... 500 shares Ctf. #595/6
G. N. Wilcox.....1850 shares Ctf. 597-598
S. W. Wilcox..... 925 shares Ctf. 593/4
Wallace M. Alexander..... 717 shares Ctf. 631
Alexander Properties Co.
By W. M. Alexander, Pres..... 208 shares Ctf. 6
E. D. Tenney ..... 100 shares Ctf. 525
Welch & Co.
J. B. McFarland, Vice President.....2300 shares Ctf. 662
Matson Navigation Company
F. A. Bailey, Secretary.....2300 shares Ctf. 669
W. P. Roth ..... 100 shares Ctf. 656

Plaintiff's Exhibit P-5—(Continued)

Exhibit 2

Excerpt from Minutes of Annual Meeting of Stockholders of American Factors, Limited, Held March 4th, 1932

"President Bottomley addressed the stockholders as follows:

'I should like to refer to the paragraph in my report which deals with the case of Isenberg et al. versus Sherman et al., or the so-called Hackfeld litigation, the expenses of which have been advanced by certain of the individual defendants pending the decision of the Court as to whether their acts were legal and the transaction a valid one. These defendants, as officers and large stockholders, participated in the organization of American Factors, Limited, and were made co-defendants with American Factors, Limited, in the litigation.

'The litigation in California, as you all know, complained of the acts of these individual defendants, as well as the acts of American Factors, Limited, in connection with the reorganization of Hackfeld & Co. and the organization of American Factors, Limited, and the suit brought in New York asked the Court to rescind the entire transaction and to charge upon the assets of American Factors, Limited, the claims of the plaintiffs to an amount of $10,000,000 and upwards.

'The claims made in these two suits show beyond any possibility of doubt that the whole structure on which American Factors, Limited, was founded

Plaintiff's Exhibit P-5—(Continued)

was attacked by this litigation and that the defendants in the suit were attacked solely because they had assisted in the formation of American Factors, Limited. Accordingly, I recommend to this meeting of Stockholders that they approve of the payment by the Company of the litigation expenses rather than have them remain as a charge against those who, under the direction of the Alien Property Custodian, were responsible for the formation of the Company.

'The Undivided Profits and Reserves of Hackfeld & Co. standing on the books of that Company as of August 18th, 1918, the date on which Hackfeld & Co. was taken over by the American Factors, Limited, were set aside as a reserve to meet any contingent claims on American Factors, Limited, or unknown liabilities of Hackfeld & Co., and I believe that the balance of this reserve could justly and properly now be used in the payment of these expenses so that the actual earnings of the Company would not be affected thereby.'

President Bottomley stated further that this matter was taken up with Mr. Oscar Sutro, attorney for the Company during the litigation, and that he feels that the whole structure of the Company was involved in the claims made by Mr. Nylen and that the litigation expenses should be paid by the Company.

An opinion of Messrs. Smith, Wild and Beebe, attorneys for the Company on this subject, dated March 3rd, 1932, which opinion is filed with the

Plaintiff's Exhibit P-5—(Continued)

records of the Secretary of the Company and made a part of these minutes, was then read to the Stockholders, this opinion reciting the view of the attorneys that it is within the powers of the corporation to make reimbursement to the individual defendants in the Hackfeld Litigation, and, further, that the corporation is under moral obligation to make such reimbursement upon proper authorization of the Stockholders.

Mr. W. F. Frear thereupon offered and moved the following resolution, to-wit:

Resolved: That the officers of this corporation be and they are hereby authorized and directed to pay on behalf of the corporation the costs and expenses of the litigation known as the Hackfeld litigation in the courts of Hawaii, San Francisco, New York and elsewhere.

The motion for the adoption of the resolution was seconded by Mr. F. L. Bellows and unanimously carried and the resolution thereby duly adopted."

[Endorsed]: Filed December 9, 1949.

The Court: Now, I think it is about time for a recess.

Mr. Wild: I just have one short offer. I have requested the Government to furnish me with a photostatic copy of the taxpayer's return for the calendar year 1932. It was furnished me this morning, and counsel states to me that it is a photostatic copy of the true return filed.

Mr. Atherton: It is certified.

Mr. Wild: And I would like to offer that certified copy in evidence.

The Court: Let me see that. (Document handed to the Court.)

Mr. Wild: I haven't had a chance to check it. I didn't even see that it was the year 1932. I think it is.

Mr. Atherton: Yes.

The Court: And the return consists of all these separate sheets?

Mr. Wild: Yes, Your Honor. It is the return in the form as prepared by the Government, with schedules attached, all certified, I take it——

Mr. Atherton: Yes.

Mr. Wild: ——as being true and correct copies, the return with the schedules attached.

Mr. Atherton: Yes, the certificate so reads. It is the correct—

The Court: Very well. What will we number that? [64]

Mr. Wild: P-6, Your Honor.

(The document referred to was received in evidence as Plaintiff's Exhibit P-6.)

PLAINTIFF'S EXHIBIT P-6

Admitted

United States of America

Treasury Department
Washington

May 29, 1940

Pursuant to the provisions of Section 661, Chapter 17, Title 28 of the United States Code (Section 882 of the Revised Statutes of the United States), I hereby certify that the annexed is a true copy of Corporation Income Tax Return for 1932 (with balance sheets and schedules attached), filed by American Factors, Limited, Honolulu, Hawaii, on file in this Department.

In Witness Whereof, I have hereunto set my hand, and caused the seal of the Treasury Department to be affixed, on the day and year first above written.

By direction of the Secretary of the Treasury:

[Seal] /s/ S. H. MARKS,
Acting Chief Clerk,
Treasury Department.